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Michael Joachim Bonell

to celebrate his 70<sup>th</sup> birthday

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# The Erosion of a Fundamental Contract Law Principle *pacta sunt servanda* vs. Modern Insolvency Law

Christoph G. Paulus\*

*Quidquid agis, prudenter agas, et respice finem*

## I HISTORICAL FRAGMENTS

The principle (or *regula*) of *pacta sunt servanda* was never expressed by the ancient Romans. Quite to the contrary, in Roman law, *pacta* originally were not actionable at all. They were mere promises without any legally binding character and as such contrasted with contracts, *contractus*. Only if and when the relevant formalities<sup>1</sup> had been complied with did such promises become obligatory and could their fulfilment be sued for. However, in some cases, the *praetor* saw the need to vest certain *pacta* with the force of legal enforceability; these so-called *pacta praetoria* thus became a special segment of the body of binding agreements.<sup>2</sup> This practice marked the beginning of a development in the course of which the clear distinction between *contractus* and *pacta* became blurred. Justinian<sup>3</sup> later created an additional segment of binding agreements in the form of so called *pacta legitima*.<sup>4</sup>

Nevertheless, the conclusion that, generally speaking, *pacta sunt servanda* was still not drawn. This was left to an institution which – *ex professo*, as it were – had to do with morals rather than with subtle legal distinctions. Referring to a synod held in Africa (Carthage) in the year 348, the *Liber Extra* of Pope Gregor IX (1227-1241) reads: *pax servetur, pacta custodiantur*: peace is to be strengthened and agreements are to be complied with.<sup>5</sup> It was, accordingly, seen as a peace-keeping mechanism that promises could be relied upon. In other words, it was an event in North Africa that was the origin of a sentence which later on<sup>6</sup> provided an enormous boost in prominence and importance – both to private law<sup>7</sup> and to public international law<sup>8</sup> – and which is the focus of this paper dedicated to my dear friend, Michael Joachim Bonell. Given his eminent expertise in and

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<sup>1</sup> Cf. GAIUS, *Institutiones* 3.89: *re, verbis, litteris, consensu contractae*.

<sup>2</sup> See, e.g., M. KASER / R. KNÜTEL, *Römisches Privatrecht*, 20. Aufl., 2014, § 46.

<sup>3</sup> Cf. *Codex Iustiniani* 4.21.17pr.

<sup>4</sup> See again M. KASER / R. KNÜTEL, § 38 Rz. 15.

<sup>5</sup> L. XI (*de pactis*) 35, 1.

<sup>6</sup> On the historical development cf. R. ZIMMERMANN, *The Law of Obligations*, 1990, p. 508 ff.; J. GORDLEY, *The Philosophical Origins of Modern Contract Doctrine*, 1991; P. WELLER, *Die Vertragstreue*, 2009, S. 70 ff.

<sup>7</sup> See, e.g., T. GEBHARDT, *Pacta sunt servanda*, 10 *Modern L.R.* 1947, 159 ff.; M.P. SHARP, *Pacta sunt servanda*, 41 *Columbia L. R.* 1941, 783 ff.

<sup>8</sup> A. VERDROSS, *Völkerrecht*, 1958, 638 ff.; P. WELLER, *Die Grenze der Vertragstreue von (Krisen-) Staaten*, 2013, S. 25 ff.; H. WEHBERG, *Pacta sunt servanda*, 53 *A.J.I.L.* 1959, 775 ff.; J.C. KUNZ, *The Meaning and the Range of the Norm Pacta Sunt Servanda*, 39 *A.J.I.L.* 1945, 180 ff.

his overwhelming knowledge of contract law in all its facets, I hope that the following observations will engage his interest.

The use of the word “observations” in the last sentence is deliberate: the thoughts set down in this paper are just that: mere observations. The purpose of this paper is not to make a case that A is the cause of B and we should, therefore, be aware of the dawning of C. Instead, it takes a historian’s perspective and confines itself merely to describing parallel developments A and B, the coexistence of which has the potential to create serious conflicts and thus to generate a new setting with unforeseen consequences that will, in turn, demand new solutions. The only intended effect of these observations is expressed by the reference to the citation of the Latin proverb given above: Whatever you do, do it prudently and bear in mind the consequences.

## II PRESENT EMANATIONS OF THE PRINCIPLE

I. Confining myself to German law and the UNIDROIT Principles and beginning with the former, it is somewhat surprising to find that in the German *Bürgerliches Gesetzbuch* (BGB), the Civil Law Code, the regula *pacta sunt servanda* is nowhere explicitly stated. What can be found, however, are other rules which evidence that this omission occurred not because the principle had been forgotten or because the drafters were concerned not to give it any validity in the BGB. Rather, it is to be assumed that the principle was understood as being so self-evident that any explicit reference to it would have been deemed superfluous. What is regulated, though, is the technical verification of the fulfilment of contracts. Sec. 241 par. 1 BGB, for instance, states: “By virtue of an obligation an obligee is entitled to claim performance from the obligor. The performance may also consist in forbearance”.<sup>9</sup>

It follows from this formulation that once an obligation (“*Schuldverhältnis*”) has come into existence, (a) a claim results therefrom, the fulfilment of which (b) can be claimed by the creditor. Given the abstract level of the systematic context into which sec. 241 BGB is placed – the General Part of the law of obligations – the term ‘obligation’ includes not only contracts but also extra-contractual relationships such as delicts or unjustified enrichment. What is important, though, for the present context is that this rule amplifies the necessity to comply with the duties stemming from contract or extra-contractual obligations. In other words, legal obligations must be fulfilled.

In its effort to ensure that the *pacta sunt servanda* principle receive whatever legislative support that might be needed to bring it about, the BGB adds in sec. 362 par. 1: “An obligation is extinguished if the performance owed is rendered to the obligee”. What looks, at first glance, like a self-evident statement is, on closer inspection, evidence that a claim like that mentioned in sec. 241 BGB remains in existence and thereby entitles the creditor to claim fulfilment until complete satisfaction. Accordingly, the obligation is extinguished only if and when the last cent owed has been paid or the last step of an action has been taken or the agreed time of forbearance has elapsed.

In contrast to some other jurisdictions, German law goes one step further in safeguarding full service of *pacta*. Its civil procedure law not only permits the parties to sue for delivery in kind but also provides for the enforcement of relevant judgments, cf. sec.

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<sup>9</sup> Translation here and subsequently taken from: [http://www.gesetze-im-internet.de/englisch\\_bgb/englisch\\_bgb.html#p0717](http://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p0717).

883 ff. of the Civil Procedure Code (ZPO). Accordingly, not only is the servicing of a *pactum* guaranteed on a voluntary basis or one which, in the worst case, results in a duty to compensate for loss sustained (*condemnatio pecuniaria*), but it is also made sure that the promised and agreed performance will be delivered even against an opposing debtor.

And yet, despite this rather impressive safeguard against any impairment of the principle, German law nevertheless also struggles with the ubiquitous problem of how to define the thin line between a legally binding promise that has to be fulfilled and a mere social agreement.<sup>10</sup> The paradigmatic invitation to a birthday party, which is generally understood to be non-binding, points to the fascinating (though unanswerable) question as to when, in the evolution of humankind, people took the decisive step of declaring promises binding. In other words, when, where, and in which circumstances were people led to create the first emanations of what we today take for granted to be a contract. It is probably safe to assume that this instrument was meant to tame the great unknown for mankind: the future. In order to make the future predictable, promises needed to be reliable.<sup>11</sup>

This is an important, if not the most important, feature of any contract: the reliability of its fulfilment. This has always been true throughout history but is especially so in modern times with their dependence on a network of economic actors around the globe. These networks go beyond groups of companies and particularly evident in the so-called global supply chains.<sup>12</sup> They describe a manner of production and cooperation in which several mutually independent manufacturers develop component parts which are then delivered to another company which puts them together in order to create the final product. Such chains nowadays reach across borders<sup>13</sup> and even continents; the recently finalized Trans-Pacific Partnership (TPP), for instance, is explicitly intended to facilitate their foundation and functioning.

To be sure, German law, like any other, provides for possibilities to bring the binding effect of a contract to an end. Suffice it to mention the right to withdraw (“*Rücktritt*”) pursuant to sec. 346 ff. BGB that is awarded either because the parties to the contract originally agreed on this right or because of certain disruptions in the course of the contractual relationship which are regarded by the law to be sufficiently serious to allow the contract to be terminated. Another, increasingly prominent possibility of ending a contract is revocation (“*Widerruf*”) pursuant to sec. 355 BGB. This forms an essential part of any modern consumer protection law and allows consumers to break off contractual relations within 14 days after the conclusion of the contract without any need to justify their action or to give just reasons. In view of the observations that follow, it should be noted that the foreseeability of revocation is probably greater than that of withdrawal, since in the former

<sup>10</sup> On this, cf., e.g., D. MEDICUS / J. PETERSEN, *Bürgerliches Recht*, 24th ed., 2013, par. 365 ff.

<sup>11</sup> As an aside, cf., e.g., S. WEYERS, *Pacta sunt servanda? Das kindliche Verständnis von Verträgen am Beispiel des Tausches und der Leihe*, *Zeitschrift für Pädagogik* 2006, 591 ff.

<sup>12</sup> On this, see P.E. MEARS / M. BARLOWSKI, *Global Supply Chains in Cross-Border Troubled Supplier Situations: Considerations for Counsel in Advising Affected GSC Members*, *Bloomberg BNA – International Trade Reporter*, vol. 32 Nr 6 02/05/2015, S. 1 ff.; P.E. MEARS / C.G. PAULUS / S. TAKAGI, *Global Supply Chains and Free Trade Agreements: A Suggested Vehicle for Harmonization of Insolvency and Contract-Enforcement Laws*, *Pratt’s Journal of Bankruptcy Law* 2015, 284 ff.

<sup>13</sup> A noteworthy article in this regard may be found in the *Financial Times* from 13 Oct 2015: *Volkswagen scandal fuels fears for jobs across Europe: Parts suppliers from Poland to Italy wait to assess effect of crisis on orders*, p. 3.

case all that is necessary to exert the right is that the respective party be a consumer, whereas in the latter case, a contractual clause is needed or the abovementioned disruption of the ordinary course of the contract fulfilment must have occurred.

II. In contrast to the German law, the Principles of International Commercial Contracts (UNIDROIT Principles) do explicitly set out the *regula pacta sunt servanda* in Article 1.3: “A contract validly entered into is binding upon the parties. It can only be modified or terminated in accordance with its terms or by agreement or as otherwise provided in these Principles.” The comment explains the meaning and implications of this principle. Its applicability, for instance, presupposes the validity of the agreement, whereas exceptions are permissible only in very limited circumstances. Despite the bilateral nature of a contract and its binding effect only for the concluding parties, such contracts might nevertheless affect third parties. The example given is the obligation of a seller to protect not only the buyer’s physical integrity while on the seller’s premises but also the integrity of those accompanying the buyer. Another example would be an exclusivity agreement between the producer of a good and a shop-owner, thereby leaving other shop-owners no chance of selling this particular good as well.

The right to terminate an agreement is provided for in Article 7.3.1. This is dependent, however, on the failure of the other party to perform an obligation under the contract. In contrast to German law, the UNIDROIT Principles do not give the parties an unconditional right to terminate. This is not really surprising, since the Principles do not deal with consumer contracts.

### III MODERN INSOLVENCY LAW

I. Literally for millennia, insolvency law has been the paradigm for a rigid law, *ius cogens*, i.e. a law that had to be applied as it was with little (if any) room for manoeuvre. Its subject has always been the physical liquidation first of the debtor and later, of the debtor’s assets. It was not until some decades ago, with the enactment of the Bankruptcy Reform Act in the U.S.A. in 1978, that its Chapter 11 proceeding gained prominence and entered into the (almost) global common awareness. What sets this Chapter apart is its objective of rescuing not only the debtor’s business but also the financially troubled debtor itself. To be sure, this does not signal the dawn of a truly humanistic era;<sup>14</sup> rather, it reflects a changed economic setting (and, in particular, the transition from the secondary economic sector with its emphasis on the manufacturing industry to the tertiary sector, usually called service economy) in which the traditional methods of a liquidation proceeding no longer provide satisfactory results.<sup>15</sup>

Insolvency law, which pursuant to the ancient Roman Twelve Table legislation was still a mechanism of revenge in that it allowed the creditors to sell the debtor *trans Tiberim* or to cut him into pieces (t. III 6), nowadays is an instrument through which those very

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<sup>14</sup> On this, cf. C.G. PAULUS, Die Insolvenz als Sanierungschance, ZGR 2005, 309 ff.

<sup>15</sup> More precisely: the typical assets of the secondary sector are *mobilia, immobilia et nomina*, and it was the Romans who taught us how to sell and, thus, instrumentalize them for the benefit of the creditors. In the tertiary sector, however, other and more person-related assets are the predominant feature: good-will, know-how, charisma, client base, etc. To benefit from them one needs the person connected with these assets.

creditors help the debtor to get back into business. A more dramatic shift in any law's evolution is scarcely imaginable.<sup>16</sup> It is accompanied by the recent appearance of agreements in the insolvency realm. Chapter 11 and all its replicas and variations around the world share a common feature, i.e., they function as an invitation to negotiate. Roughly speaking, they give debtors and creditors an incentive to sit down at the table and to negotiate a solution that will permit the debtor to survive and to create income in the future which can then be used to satisfy the creditors.

Of course, what has just been coined as incentive might in fact be more or less rigid pressure, and in most, if not all, cases negotiating includes acting in the shade of a majority vote. As a matter of fact, the replacement of the unanimity requirement outside an insolvency proceeding by a majority vote inside is one of, if not *the* greatest, attractions of this procedure. Nevertheless, the disposability of insolvency instruments has far-reaching implications – for the purposes of this paper, suffice it to mention just the possibility of resorting to mediation in the context of insolvency proceedings.<sup>17</sup>

II. A further corollary of the expansion of the insolvency concept from what was originally mere liquidation to what is now attempting to rescue companies is that it necessitates a re-mapping of this field of law. Whereas insolvency was formerly the end of a downward spiral, possibly adjacent to enforcement law and maybe labour law (when, for instance, labour contracts were disrupted due to the debtor's liquidation) it has now acquired a whole bunch of new “neighbours” with whom adjustment is to be found.<sup>18</sup>

One such neighbour, for example, is company law. If and when insolvency law offers an opportunity to opt for a debt-equity-swap, the voting and decision-making rules within the company need to be adjusted. Competition law, too, is affected by the new insolvency options: both fields take care of the effective functioning of the market,<sup>19</sup> but in different ways. They collide, for instance, if and when a competitor seeks to take advantage of specific features of an insolvency proceeding, such as greater ease of termination of the contract or temporary protection from pressing creditors.<sup>20</sup>

Capital market law is another new companion of insolvency law, for example with regard to the so-called secondary market for distressed debts (or non-performing loans);

<sup>16</sup> See also W. UHLENBRUCK, Vom „Makel des Konkurses“ zur gesteuerten Insolvenz, *FS Gerhardt*, 2004, S. 979 ff.

<sup>17</sup> See C.G. PAULUS, Gerichtliche und außergerichtliche Verfahrensansätze zur Unternehmensrestrukturierung, in U. Hommel / T.C. Knecht / H. Wohlenberg (eds.), *Handbuch Unternehmensrestrukturierung*, (to appear in 2016)

<sup>18</sup> On what follows, see C.G. PAULUS, Insolvenzvermeidung und Insolvenzverfahren, in *Festschrift Hakan Pekcanitez*, 2015, Special Issue Dokuz Eylül Üniversitesi Hukuk Fakültesi Dergisi, 16, Bd. III, 2014, p. 2345 ff.

<sup>19</sup> On this, cf. A. VALLERY / E. HUJOEL, La loi sur la continuité des entreprises à l'épreuve du droit de la concurrence in *Actualité de la continuité, continuité de l'actualité, États généraux de la continuité des entreprises*, under the direction of A. Zenner and M. Dal, Barreaux de Bruxelles Ordre français, 651 ff. (Larcier, 2012); C.G. PAULUS, Competition Law vs. Insolvency Law – When Legal Doctrines Clash, *Uniform Law Review* 2013, 65 ff. On anti-trust issues in the context of selling assets by the insolvency administrator cf. S. RIEL, Das Insolvenzverfahren über das Vermögen der ALPINE Bau GmbH – ein Zwischenbericht, *ZIK* 2014, 174, 176.

<sup>20</sup> Regarding the advantages and disadvantages of a restructuring of the inside and outside of an insolvency proceeding, cf. P. STRÜMPELL, Die übertragende Sanierung, 2006.

this market segment can prevent insolvencies as it can cause them. This was only recently impressively demonstrated in a recent lawsuit, *NML Capital, Inc. vs. Argentina*. Plaintiff had bought Argentinian bonds at a steep discount on that market and – successfully – sued for full payment.<sup>21</sup> Capital market law is also affected when bond issues are at stake and the issuer becomes insolvent.<sup>22</sup>

Procurement law likewise has the potential of intruding into the modern insolvency realm, for instance when the restructuring of public enterprises such as public utilities or public power generators is at stake, or when the public authorities put out tenders and the lowest bid comes from a company subject to an insolvency proceeding.<sup>23</sup> Even though not yet topical or even discussed at all, it is to be assumed that rather sooner than later insurance law, too, will join the neighbourhood, since credit-default-swaps, both feared and widely used, are actually a form of insurance against the default risk. Takeover law is another such case: the slogan ‘loan to own’ is gaining prominence and refers to the use of insolvency law and its abovementioned debt-equity-swap mechanism as a way of circumventing the pitfalls of takeover law. Corporate governance, too, is to a huge extent nothing but a sort of negative imprint of past crises and prominent insolvency cases.

The most surprising new neighbour, however, is public international law. Since when and if insolvency law offers the opportunity to rescue the debtor, and since the U.S. Bankruptcy law, for instance, provides its Chapter 9 proceeding for stumbling municipalities such as Detroit<sup>24</sup> or even New York,<sup>25</sup> it would be just a small step to extend this concept to sovereign States. Many proposals have been submitted;<sup>26</sup> they mostly refer in one way or the other to modern insolvency law.<sup>27</sup>

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<sup>21</sup> Zu dem Verfahren R. OLIVARES-CAMINAL, Is a Public Debt a Public Curse?, *Intl. Corporate Rescue* 2013, 353 ff.; C.G. PAULUS, Jüngste Entwicklungen im Insolvenzrecht, WM 2013, 489; *idem*, Insolvenzrecht im Werden – NML Capital, Ltd. et al vs. Argentinien, 2. Runde, ZIP 2013, 2190 ff.; C.G. PAULUS / R. VAN DEN BUSCH, Von Ausharrenden und Geiern, WM 2014, 2015 ff.

<sup>22</sup> See C. THOLE, Die Restrukturierung von Schuldverschreibungen im Insolvenzverfahren, ZIP 2014, 293 ff.; T. FLORSTEDT / P. VON RANDOW, Die Kündigung von Anleiheschuldverhältnissen aus wichtigem Grund, ZBB 2014, 345 ff.; C.G. PAULUS, Schuldverschreibungen, Restrukturierungen, Gefährdungen, WM 2012, 1109 ff.

<sup>23</sup> Cf. VgK Brandenburg, dec. from 19.12.2013 – VK 23/13, NZI 2014, 933.

<sup>24</sup> Cf. P.E. MEARS, Kommunale Insolvenzen und das Chapter 9-Verfahren des U.S. Bankruptcy Codes: Die Geschichte des Chapter 9-Verfahrens und dessen Wirkung im Restrukturierungsverfahren der Stadt Detroit, ZInsO 2015, 1813 ff.

<sup>25</sup> Cf. <http://www.newyorker.com/news/news-desk/the-night-new-york-saved-itself-from-bankruptcy>.

<sup>26</sup> A collection of various proposals at U. PANIZZA / F. STURZENEGGER / J. ZETTELMEYER, The Economics and Law of Sovereign Debt and Default, *Journal of Economic Literature*, 2009, 47:3, 651 ff.; K. ROGOFF / J. ZETTELMEYER, Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976-2001, *IMF Staff Papers* 49, nr. 3, 2002; IMF, Sovereign Debt Restructuring – Recent Developments and Implications for the Fund’s Legal and Policy Framework, April 26, 2013.

<sup>27</sup> See, e.g., C.G. PAULUS, Die Eurozone und das größere Thema eines Staateninsolvenzrechts, in G.E. Kodek / A. Reinisch (eds.), *Staateninsolvenz*, Wien 2011, p. 9 ff.; *idem*, Lehren aus den vergangenen Krisen und neue Ansätze zur Staateninsolvenz, in: T. Giegerich (ed.), *Internationales Wirtschafts- und Finanzrecht in der Krise*, 2011, p. 135 ff.; *idem*, Geordnete Staateninsolvenz – eine Lösung mit Hilfe des Vertragsrechts, ZIP 2011, 2433 ff.; *idem*, Gläubiger oder neutrale Instanz – wer soll das schlingernde Schiff steuern?, ZSE, 2012, 30 ff.; *idem*, Sovereign Defaults to be Solved by Politicians or by a Legal Proceeding?, *Law and Economics Yearly Review* Vol. 1, Part 2, 2012, p. 203

III. The most recent development of modern insolvency law is, however, its extension to insolvency prevention. In order to understand this latest step in the evolution of the broadening concept of insolvency law, it should be borne in mind that restructuring laws in Europe entered into a competition some years ago which makes the European restructuring and insolvency landscape look like a market place.<sup>28</sup> It is to be assumed that massive economic interests are at stake when it comes to attracting foreign companies to the domestic courts.

The most active “sellers” of this product are the U.K. and France. The latter in particular has created several new instruments in recent years designed to avoid an upcoming insolvency proceeding (*Procédure de sauvegarde* and its variants, the most recent one the *Loi Macron; procédure de conciliation, mandat ad hoc*). The U.K. is very prominent with its Scheme of Arrangement which allows debtor companies to have their debts restructured by an English court without moving their seat or headquarters to England. In his decision regarding the relevant attempt by a German firm, Rodenstock,<sup>29</sup> Judge Briggs intentionally elaborates at great length on when and under which circumstances foreigners will be admitted to make use of an English Scheme of Arrangement; it reads like a promotional prospect for a fine English product.

This Scheme may here serve as a model for all the other examples of insolvency avoidance procedures. Regulated in sec. 895 ff. of the Companies Act 2006,<sup>30</sup> the Scheme of Arrangement uses its remarkable flexibility and variability to allow a custom-built restructuring of all or some of a debtor’s financial obligations. Its main instrument is the application of the majority principle which makes it possible to outvote dissenting minority holders. Thus, whenever in a given class of creditors the simple majority votes in favour of the proposal and this majority represents three fourths of the aggregated amount of the claims included into this class, the dissenting minority is bound by the result of the vote. Of course, this process is embedded in a procedure which is supervised to a certain degree by the court; it is therefore the court which ultimately has to approve the terms after examining their fairness and transparency. However, the debtor need not be insolvent or even just at risk of becoming so.

The appeal of this procedure is increased by the fact that the Scheme of Arrangement does not interpret itself as an insolvency proceeding, since this allows foreign companies to make use of it without having to shift their Centre of Main Interests from their home base to the United Kingdom, cf. Article 3 European Insolvency Regulation. Not only does this save costs for these companies, but it is also perceived as an incentive to other legislators to adjust their own laws. Germany, for instance, introduced an insolvency law amendment shortly after the first German companies went to London to avail themselves of the Scheme of Arrangement. The amendment is referred to as the ‘law for the

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ff. See also C.G. PAULUS / I. TIRADO, Sweet and Lowdown: A Resolvency Process and the Eurozone’s Crisis Management Framework, *Law and Economics Yearly Review* 2013, p. 504 ff.

<sup>28</sup> H. EIDENMÜLLER, Recht als Produkt, *JZ* 2009, 641 ff. More generally, regarding economic competition A. HELDRICH, Profane Gedanken über die Hintergründe der Rechtsvergleichung, *Festschrift Kitagawa*, 1992, p. 157 f., esp. p. 159.

<sup>29</sup> High Court in London, dec. of 6.5.2011 - [2011] EWHC 1104 (Ch), NZI 2011, 557. Cf. also the subsequent dec. of 20.1.2012 - [2012] EWHC 164 (Ch), ZIP 2012, 440.

<sup>30</sup> On the following, cf., e.g., V. FINCH, *Corporate Insolvency Law*, 2<sup>nd</sup> ed., 2009, p. 479 ff.

further facilitation of company restructuring'.<sup>31</sup> However, even though Germany thought it had thereby rendered its law sufficiently competitive for said market place, the European Commission is now pressing even harder to achieve an even more progressive mode of restructuring.

On 12 March 2014, the European Commission published what it called a Recommendation<sup>32</sup> but which, in the long run, will have the effect of a model law with restricted room for domestic adjustments. The recommendation closely resembles the Scheme of Arrangement. Based on the narrative of Henry Ford's life achievement – the founding of a global enterprise only months after a first attempt failed – the text recommends reducing the involvement of the courts in such proceedings to a few agenda items such as the granting of a kind of moratorium and final control of creditor protection and the legality of the procedure. What is essential, however, are the twelve rather detailed rules which an insolvency avoidance proceeding is supposed to contain: above all, the replacement of the unanimity requirement by a majority vote, but also an *Actio-Pauliana* exception, a strict understanding of debtor in possession (i.e., without supervision by a trustee) and the possibility to restrict the restructuring process to a particular group of creditors.

#### **IV IMPACT ON PACTA SUNT SERVANDA**

I. It should be understood that any restructuring of the debt burden implies a change of contract. Be it in the realm of commerce, that of sovereign States or the private realm, a reduction of the debtor's burden can be achieved only if and when the creditor agrees either to a reduction of the principal obligation or the interest rate, to a prolongation of the repayment terms or to a blend of these three options. Since each of these alternatives affects the rights of the creditors and since these rights enjoy property protection under the German Constitution, Article 14 *Grundgesetz*, the prevailing opinion in Germany has been (and probably still is) that the unanimity requirement for contract changes can be impaired only under very limited circumstances, the most prominent being the debtor's insolvency as defined in sec. 17 to 19 *Insolvenzordnung*; another would be participation in a bond issuance, sec. 5 *Schuldverschreibungsgesetz*.

Attempts at introducing an insolvency avoidance mechanism in Germany have been rejected so far despite increasing objections from various sides.<sup>33</sup> This will probably change

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<sup>31</sup> Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen vom 7.12.20011, BGBl I S. 2582 ff. (ESUG).

<sup>32</sup> C(2014) 1500 final. On this, cf., e.g., S. MADAUS, The EU Recommendation on Business Rescue – Only Another Statement or a Cause for Legislative Action Across Europe?, (2014) 27 *Insolvency Intelligence*, Issue 6, S. 81 ff.; H. EIDENMÜLLER, Die Restrukturierungsempfehlung der EU-Kommission und das deutsche Restrukturierungsrecht, KTS 2014, 401 ff.; C.G. PAULUS, Betriebs-Berater, Die Erste Seite Heft 18/2014.

<sup>33</sup> See, for instance, the divergent arguments from a workshop at the German Ministry of Economics in Paulus, WM 2010, 1337 ff.; P.A. WINDEL, Das Prinzip der Selbstverantwortung und das Insolvenzrecht, in K. Riesenhuber (Hg.), *Das Prinzip der Selbstverantwortung*, 2011, S. 450, 485; V. BEISSENHIRTZ, Plädoyer für ein Gesetz zur vorinsolvenzlichen Sanierung von Unternehmen, ZInsO 2011, 57; R. BORK, Vorinsolvenzliches Sanierungsverfahren: Schuldverschreibungsgesetz analog?, ZIP 2011, 2035; F. JACOBY, Vorinsolvenzliches Sanierungsverfahren, ZGR 2010, 359–384;

in the wake of the Commission Recommendation. And while there is every reason to welcome the facilitation of company restructurings and the advantages of a second chance for entrepreneurs, the implications for the much more fundamental principle of *pacta sunt servanda* are serious. Of course, the single incident of an insolvency avoidance mechanism does not in itself pose a real threat to the validity of *pacta sunt servanda*, but it is one further drop in addition to, for instance, consumer protection law with its aforementioned revocation right.

For sceptics who might regard this admonition or conclusion as overly pessimistic, a small-scale and a large-scale observation is proposed. The former refers to the simple fact that the seemingly booming sector of internet-shopping (for shoes, clothes, books, etc.) is overshadowed by the fact that 50% of deliveries<sup>34</sup> are sent back by buyers within the prescribed timeframe. The large-scale observation is the emergence of compliance in the commercial sector. Companies employ their own staff which is in charge of compliance. Their task, in a nutshell, is to make sure that the law is applied and observed in all the company does. This is surprising if one takes for granted that law, by definition, is something that must be applied and observed. The fact that compliance is today a task in its own right begs the conclusion that lawmaking and its application is no longer a *hendiadyoin*. They are no longer intermingled and have become two sides of a coin. Law is no longer automatically that which has to be applied at all times.

II. An obvious and understandable reaction to the above deliberations would be to complain about the loss of the true value of law in our time, about the decline of its certainty and its predictability. Alternatively, however, we might begin to wonder what is behind these modern trends and where will they lead to. Obviously, this is not the place to dwell on these issues at any length. Only some rather scattered ideas can be presented here which might give a first clue as to the direction into which we should look for correct answers.

The principle of *pacta sunt servanda* is based on the assumption that once the contract has been concluded by the parties, its outcome and effects are predictable until full performance of the obligations. This certainty is about to vanish or, at least, diminish. A static construction is thereby replaced by a dynamic one: absolute certainty gives way to relative certainty. Put in these terms, the evolution described in this paper in many respects resembles the transition from the Roman law world into a modern one. No one has described this more painstakingly, more prophetically, and more accurately than Oswald Spengler<sup>35</sup> in his monumental treatise '*Der Untergang des Abendlandes*'.<sup>36</sup> According to him, the ancient law was a law of things (*Körpern*), whereas the modern law is one of functions.

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A. BRAUN, Die vorinsolvenzliche Sanierung von Unternehmen, 2015, S. 22 ff.; C. GELDMACHER, Das präventive Sanierungsverfahren als Teil eines reformierten Insolvenz- und Sanierungsrechts in Deutschland, 2012, S. 155 ff.; see also S. MADAUS, Vorinsolvenzliche Sanierungsverfahren – Perspektiven einer europäisch geprägten Rechtsentwicklung, KSzW 2015, 183, 185 ff.

<sup>34</sup> Cf. <http://www.sueddeutsche.de/wirtschaft/online-handel-zalando-sagt-shit-happens-1.2679622>.

<sup>35</sup> On Spengler, cf D. JOOST, Eine vergangene Zukunft der Rechtswissenschaft, JZ 1995, 11. But see also C.G. PAULUS, Überlegungen zu einem modernen Konzerninsolvenzrecht, ZIP 2005, 1947, 1948.

<sup>36</sup> Edition in 2 volumes, dtv, 2<sup>nd</sup> ed., 1973, vol. 2, p. 624 ff.

In such a context of functionality, the tasks that the law has to fulfil differ from those in the Roman law world. Functionality can, indeed, be discerned in many new areas: suffice it to mention consumer law, the law of secured transactions, payment law, etc. If a new civil law code were to be developed from scratch, the traditional contract classification would have to be modernized and amended (or even replaced) by much more appropriate types such as pursuit of others' interests<sup>37</sup> or knowledge distribution. In this new setting, the functions of a contract are likely to undergo essential changes.<sup>38</sup> If this is true, the foregoing observations give reason not so much for pessimism but for curiosity about where we are headed and which principle will replace the time-honoured *pacta sunt servanda*.

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<sup>37</sup> Cf. K.J. HOPT, *Interessenwahrung und Interessenkonflikte im Aktien-, Bank und Berufsrecht – Zur Dogmatik des modernen Geschäftsbesorgungsrechts*, ZGR 2004, 1 ff.; *idem*, *Prävention und Repression von Interessenkonflikten im Aktien-, Bank- und Berufsrecht*, FS Doralt, 2004, p. 213 ff.

<sup>38</sup> My colleague Stephan Madaus draws my attention to Markus Rehberg's work on *Das Rechtfertigungsprinzip – eine Vertragstheorie*, 2014.