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*Professor*

# The Eternal Struggle for Supremacy between Creditor and Debtor*

## 1. Beginnings

### 1.1. From search for peace to contract

Talking about a power game in credit relationships might be seen as a *contradictio in adiecto* since there is necessarily a contractual link between at least two persons, a debtor and a creditor. Given this prerequisite, it seems like a surprise that this role is and always has been determined by a struggle for power. After all, a contract appears to be by definition a peace-maker: the Latin word 'pactum' is derived from the notion of *pacisci* (to make peace), and the German word 'Vertrag' is based on the root of the verb 'vertragen' (i.e., to get along). There is no better evidence for the equalising effect of a contract than the Old Testament and God's relationship with the Hebrews therein: once God has entered into the agreement with Noah to never again destroy mankind, Abraham is in a position to remind the Lord to keep this promise also in the case of Sodom and Gomorrah.*[1] But alas, irrespective of such most venerable precedents, human reality has it that the creditor–debtor relationship always has been and most probably will remain a power game, now and forever. This insight was presented in masterly fashion quite some time ago by Prof. Rudolf von Ihering in his seminal treatise *Der Kampf ums Recht* ('The Struggle for Law').*[2]

A few snapshots from the constant fluctuation entailed by this struggle are presented below, with emphasis placed on the most dramatic situation arising in a contractual relationship – namely, the debtor's inability to comply with his contractual obligation, a situation that we are used to branding today as bankruptcy, insolvency, or the like.*[3] From a Romanistic stance, it would be most natural to begin this historical description with the Romans: after all, they are the ones who discovered and instrumentalised the two-person relationship of creditor–debtor and of plaintiff–defendant, respectively, as the 'atom' of legal science, and they are known for their notorious brutality in the Twelve Tables legislation from around 450 BC.

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* This article is a revised version of a chapter in a book edited by Abel B. Veiga Copo and Miguel Martínez Muñoz: *El Acreedor en el Derecho Concursal y Preconursal a la luz del Texto Refundido de la Ley Concursal*, 2020, p. 39 ff. I dedicate this article to my friend Professor **Paul Varul** on his 70th birthday.

1 Very instructive with regard to this evolution is Erich Fromm. *Ihr werdet sein wie Gott*, 2018 reprint, p. 250 ff.

2 Rudolf von Ihering. *Der Kampf ums Recht*, 1872.

3 See also Jay Lawrence Westbrook. 'The control of wealth in bankruptcy'. *Texas Law Review* 2004(82)/4, pp. 795–862 (who includes security interests in his deliberations).

## 1.2. Mesopotamia and the Near East

But before one turns to these, it is advisable to start earlier and with a geographically somewhat shifted location – Mesopotamia – for their example's better classification. More precisely, we begin with the Codex Hammurapi, of some 4,000 years ago.[*4] In its Art. 117, one finds this rule[*5]:

> If anyone fail to meet a claim for debt, and sell himself, his wife, his son, and [his] daughter for money or give them away to forced labor: they shall work for three years in the house of the man who bought them, or the proprietor, and in the fourth year they shall be set free.

Surprisingly, one finds here a rather tame concept of sanctioning; by modern categorisation, this rule is a very debtor-friendly one. Not dissimilar to this, the hand behind the Old Testament of the Bible devised a nearly more magnificent concept. Accordingly, debt bondage was limited to seven years:

> If thou buy an Hebrew servant, six years he shall serve: and in the seventh he shall go out free for nothing.[*6]

Additionally, a loan could be reclaimed within the limits of a seven-year period only[*7]:

> (1) At the end of every seven years thou shalt make a release.
> (2) And this is the manner of the release: Every creditor that lendeth ought unto his neighbor shall release it; he shall not exact it of his neighbor, or of his brother; because it is called the LORD's release.
> (3) Of a foreigner thou mayest exact it again: but that which is thine with thy brother thine hand shall release.

And, finally, every fifty years there was something of an all-encompassing release[*8]:

> (8) And thou shalt number seven sabbaths of years unto thee, seven times seven years; and the space of the seven sabbaths of years shall be unto thee forty and nine years. (9) Then shalt thou cause the trumpet of the jubilee to sound on the tenth day of the seventh month, in the day of atonement shall ye make the trumpet sound throughout all your land. (10) And ye shall hallow the fiftieth year and proclaim liberty throughout all the land unto all the inhabitants thereof: it shall be a jubilee unto you; and ye shall return every man unto his possession, and ye shall return every man unto his family. (11) A jubilee shall that fiftieth year be unto you: ye shall not sow, neither reap that which groweth of itself in it, nor gather the grapes in it of thy vine undressed. (12) For it is the jubilee; it shall be holy unto you: ye shall eat the increase thereof out of the field. (13) In the year of this jubilee ye shall return every man unto his possession. (14) And if thou sell ought unto thy neighbor, or buyest ought of thy neighbor's hand, ye shall not oppress one another: (15) According to the number of years after the jubilee thou shalt buy of thy neighbor, and according unto the number of years of the fruits he shall sell unto thee:

That so-called Jubilee tradition is probably even older than this Biblical report.[*9] Much later, from 1300 AD, it played a certain role within Christianity[*10] and gained great attention again within certain circles in the

4 For what follows, see esp. Stephan Madaus. 'Schulden, Entschuldung, Jubeljahre – vom Wandel der Funktion des Insolvenzrechts'. *Juristenzeitung* (JZ) 2016(71)/11, pp. 548–556, on p. 552 ff. – DOI: https://doi.org/10.1628/002268816x14570156355636; Christoph Paulus. 'Historische Betrachtungen zur Restschuldbefreiung des Schuldners'. *Zeitschrift für das gesamte Insolvenz- und Sanierungsrecht* (ZInsO) 2019, p. 1153 ff.

5 Per http://www.general-intelligence.com/library/hr.pdf, translated by L.W. King.

6 Exodus (2nd Moses) 21: 2, available at http://www.htmlbible.com/kjv30/B02C021.htm.

7 Deuteronomy (5th Moses) 15: 1–3.

8 Leviticus (3rd Moses) 25: 8–15. A comprehensive historical and theological interpretation is offered by J.S. Bergsma. *The Jubilee from Leviticus to Qumran*, 2007. – DOI: https://doi.org/10.1163/ej.9789004152991.i-353; see, additionally, A. Michel (ed.). *Èthique du Jubilé – vers une réparation du monde?*, 2005.

9 See G. Scheuermann (ed.). *Das Jobeljahr im Wandel*, 2000.

10 It was Pope Boniface VIII who introduced this Jewish concept into Christianity, by the bull *Antiquorum habet fide relatio*; see Herbert Thurston. 'Holy Year of the Jubilee' in Charles G. Herbermann (ed.), *The Catholic Encyclopedia (1907–1912), Vol. 7*, available at https://en.wikisource.org/wiki/Catholic_Encyclopedia_(1913)/Holy_Year_of_Jubilee.

transition from the 20th to the 21st century, thanks to Pope John Paul II's 'Urbi et Orbi' speech of 1 January 2000.[*11]

It is fair to conclude from these sources that in this region of the ancient world the idea was prevalent (or at least widespread) that non-fulfilment of one's obligations was neither a crime that rose to the level of capital punishment nor a misdemeanour that stigmatised the culprit for the rest of his life (and his relations as well); it was obviously rather a phenomenon that justified the creditor making a claim for the debtor's effort of repairment but just for a limited period of time.

# 2. Further developments – brutal and harsh

## 2.1. Ancient Rome

Almost diametrically opposed to that Mesopotamian approach is the one we find – and are nearly accustomed to – from ancient Roman law, which has formed a deep and lasting impression on our attitude. It is a well-known fact that the first expression of what creditors are allowed to do with a non-performing debtor is to take revenge[*12]; in the above-mentioned famous Twelve Tables legislation from roughly 450 BC we read:

> On the third market day the creditors shall cut shares. If they have cut more or less than their shares it shall be without prejudice.[*13]

This brutal approach, which laid the foundation for the strong European belief in the stigma of insolvency and which still was echoed some 2,000 years later in Shakespeare's play *The Merchant of Venice*[*14], was somewhat softened in that the creditor could, alternatively, sell the debtor abroad – more precisely, across the Tiber, to what is today Trastevere. Modern authors (or at least some of them) remain doubtful as to whether Quintilian's and Cassius Dio's statements that the brutal sanction was never actually applied are historically correct.[*15] Given the brutality of the popularly beloved circus and gladiatorial games[*16] in the centuries before and, even more, in those that followed, these doubts seem to be well-founded.

The option of seeking economic benefit rather than taking a purely avenging approach indicates a future trend insofar as general interest, probably around 100 BC (presumably sparked by the praetor Rutilius in 118[*17]), increasingly became focused on the distribution of the debtor's remaining assets. However, this 'victory' of economic reason over blind revenge did not go so far that the debtor would have been spared from sanction; he incurred *infamia*, under a shaming mechanism that, particularly in societies such as the Mediterranean ones with their strong concept of honour, is grave and comes close to what in later times was called a civilian death.[*18] It was some 100 years after

11 The Pope recommended general forgiving of all debts of the developing countries, which sparked discussion of the need to establish insolvency proceedings for sovereigns; see Christoph Paulus. 'Taugt das Insolvenzrecht als Vorlage für ein Staaten-Resolvenzrecht?'. Zeitschrift für das internationale Wirtschaftsrecht (IWRZ) 2017, p. 99 ff.

12 See also Christoph Paulus. 'Ausdifferenzierungen im Insolvenz- und Restrukturierungsrecht zum Schutz der Gläubiger'. JZ 2019, p. 11 ff. – DOI: https://doi.org/10.1628/jz-2018-0280.

13 Taken from https://avalon.law.yale.edu/ancient/twelve_tables.asp.

14 Towards the end of the 19th century, there was a famous debate in German scholarship about this play (which even led to a breach of friendship) between J. Kohler (see the article 'Shakespeare vor dem Forum der Jurisprudenz', 1883) and Ihering (see *Der Kampf ums Recht*, 1872); details are available at http://www.wjg.at/geschichte/.

15 Quintilian. *Institutio Oratoria*, Book 6, Chapter 3, §84; Cassius Dio. *Historia Romana*, frag. 16.8.

16 On this, see Keith Hopkins. *Death and Renewal*. Cambridge 1983. – DOI: https://doi.org/10.1017/cbo9780511552663, reviewed by Christoph Paulus for *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte: Romanistische Abteilung* (ZSS: Rom. Abt.) 1986(103), p. 514 ff.

17 With reference to this discussion, see E. Huschke. 'Über die Rutilische Concursordnung und das fraudatorische Interdict'. *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte: Germanistische Abteilung* (ZSS: Germ. Abt.) 1870(9), p. 329 ff. – DOI: https://doi.org/10.7767/zrgga.1870.ix.1.329; Okko Behrends. *Der Zwölftafelprozeß*, 1974, p. 184 ff.; Pilar Pérez Álvarez. *La Bonorum Venditio*, 2000, pp. 75, 78 ff. See also Inge Kroppenberg's journal article 'Die Insolvenz im klassischen römischen Recht: Tatbestände und Wirkungen außerhalb des Konkursverfahrens', from 2001, p. 68 ff. See also Louis Edward Levinthal. 'The early history of bankruptcy law'. *University of Pennsylvania Law Review* 1917–18(66), pp. 223–250, on pp. 223, 235 f. – DOI: https://doi.org/10.2307/3314078.

18 Cf. Fabian Klinck. 'Die vorklassische Personalvollstreckung wegen Darlehensschulden nach der lex Poetelia'. ZSS: Rom. Abt. 2013(130), pp. 393, 403 f. – DOI: https://doi.org/10.7767/zrgra.2013.130.1.393.

this[*19] that *princeps* Augustus took a closer look at exactly this sanction and modified it in an interesting manner by introducing the invention of *cessio bonorum*.[*20]

It is fair to assume that those roughly 100 years of civil war had thinned out the highest stratum of the society (from which the leaders and the societal elite had always been recruited) to such a degree that the *princeps* was bound to think about measures to stop that shrinking and, still better, expand this social group again. The main tool for the latter was the famous marriage legislation *leges Iulia et Papia*[*21], and the former was handled, i.a., by said *cessio bonorum*, which prevented bankrupt persons from being subjected to *infamia*. Thus, when and if the debtor volunteered to assign all his assets to his creditors, he was allowed to keep his honour. The *cessio* is, accordingly, the root of what we today take as a matter of fact: the right of the debtor to initiate a proceeding.

However, the debtor-friendliness did not survive so long; the creditors were not yet ready to relinquish the revenge part. After some indications already around the time of Emperor Iustinian, later centuries retained the term 'cessio bonorum'[*22] but introduced stigmatising signs of branding. To wear a green or in some cases a white cap was a rather innocuous one. In some regions, the bankrupt person had to go to a public central location in the town while completely undressed and beat his posterior three times against a stone (an example is still visible in Padova, Italy) while shouting 'cedo bonis'.[*23]

## 2.2. The Middle Ages and early modern times

The stigma of insolvency dominated the attitude toward a bankrupt person throughout. It is possibly a consequence of the above-mentioned Roman-law-grounded concentration on the legal technicality of a debt whereby the debtor is obliged to perform what he owes and the creditor is empowered to claim what is owed that the humanistic aspect of the two-person relationship between creditor and debtor got somewhat lost. The preponderance of the creditor's position becomes visible in many facets of the treatment of a failing debtor: thus, insolvency law became increasingly seen as part of criminal law, with the consequence of the emergence of debtors' prisons,[*24] of equating the bankrupt with a thief,[*25] of capital punishment, etc.[*26] Even though the often-declared explanation that the word 'bancarotta' stems from the breaking of a banker's bank is presumably wrong,[*27] this assumption does give a hint of the direction in which people tended to think when talking about a ruined creditor–debtor relationship. It was no wonder that debtors

19 Some decades before Augustus, Servius Sulpicius Rufus had already permitted a somewhat unorthodox method to escape from that *infamia*; see David Daube. *Roman Law: Linguistic, Social, and Philosophical Aspects* 1969, p. 93 f. – DOI: https://doi.org/10.2307/839205.

20 See Dig. 42, 3; on *cessio bonorum* in general, consult in particular Walter Pakter. *Festschrift für Sten Gagnér*, 1991, p. 327 ff.; W. Pakter. The mistery of 'cessio bonorum'. *Index* 1994(22), pp. 323–342, on p. 323; Christoph Paulus & Cornelius Renner. 'Ein weiteres Plädoyer für unscheinbare Normen'. *Juristische Schuldung* (JuS) 2004, p. 1051; Christoph Paulus. 'Ein Kaleidoskop der Geschichte des Insolvenzrechts'. JZ 2009, p. 1148 ff. – DOI: https://doi.org/10.1628/002268809790030312. The Swiss insolvency law has in its Art. 317 SchKG (Gesetz über die Schuldbetreibung und Konkurs) the 'Nachlassstundung mit Vermögensabtretung', which is, as a matter of fact, almost a copy of the Roman *cessio bonorum*.

21 On this, see, for example, Dieter Nörr. 'The matrimonial legislation of Augustus'. *The Irish Jurist* 1981(16), p. 350; Riccardo Astolfi. *La lex Iulia et Papia*, 2nd ed., 1986; Angelika Mette-Dittmann. *Die Ehegesetze des Augustus*, 1991.

22 References given by, for instance, Adolph Wach. 'Der Manifestationseid in Italien'. ZSS: Germ. Abt. 1868(7), pp. 439–474, on p. 446 ff. – DOI: https://doi.org/10.7767/zrgga.1868.vii.1.439. Cf. particularly David Mevius. *Theatri Concursus Creditorum Diaskepsis de Cessione Bonorum*, 1637, in reaction to the 30 Years' War.

23 See James Q. Whitman. 'The moral menace of Roman law and the making of commerce: Some Dutch evidence'. *The Yale Law Journal* 1996(105)/7, pp. 1881–1889, on p. 1873 (referring to the *Tractatus Matthaei Bruni Ariminensis de ceβione Bonorum*). – DOI: https://doi.org/10.2307/797235; additionally, see Friedrich Hellmann: *Lehrbuch des deutschen Konkursrechts*, 1907, p. 15 f.; *Zur Geschichte des Konkursrechts der Reichsstadt Ulm*, 1909, p. 25; *Das Konkursrecht der Reichsstadt Augsburg*, 1905, p. 98. Also see Christoph Becker. 'Bancarottierer'. KTS 2008(69)/1, pp. 3–20, on p. 8 ff. For the Netherlands, see also Johannes Wilhelmus Wessels. *History of the Roman-Dutch Law*, 1908, p. 661 ff. – DOI: https://doi.org/10.2307/3313446.

24 See Julia Anna Maria Schmitz-Koep. *Die Schuldhaft in der Geschichte des Rechts in Deutschland, England und den USA*, 2019, p. 47 ff.

25 Just see Christoph Paulus. 'Antwerpen 1515 – ein europäischer Urknall des Konkursrechts', KTS 2019, pp. 125, 130 f.

26 In Balzac's France, many traces of this criminalisation still can be studied.

27 Consult Sandor E. Schick. 'Globalization, bankruptcy and the myth of the broken bench'. *American Bankruptcy Law Journal* 2006(80)/2, pp. 219–260, on p. 252 ff.

preferred to flee from such harsh consequences[*28]; for centuries, the notion of *fugitivus* was nothing but an alternative brand for one who is bankrupt.[*29]

What is more, even the Christian Church did not arrive at a milder concept; thus, even the Church accepted the unshakeably strong position of the creditor. The Novella of Emperor Constantine XVII Porphyrogenetus from 947 AD[*30] is exceptional insofar as it refers to Jesus Christ's sacrifice and its model character in rendering of a debtor-friendly judgement. And, irrespective of the above-mentioned adoption of the concept of the Jubilee year by the Christian Church in 1300, even the eminent School of Salamanca with its incredibly open-minded liberal and progressive priests, scholars, and lawyers never did advocate debt relief; a prolonged term for repayment or delivery was all they pleaded for.[*31]

## 2.3. Modern times

### (a) Debtors gain ground

Thus, in the power game between creditor and debtor it was the former who stayed in control throughout the various ages of European thought. It was only economic necessities that led to a change. Even though certain elements of what nowadays is commonly known as a legal entity or juridic person had been discovered in previous eras – e.g., the existence of a transpersonal something beyond the individuals in an association – it is only in modern times that this legal fiction became fully developed as an instrument by which a debtor's assets are removed from the reach of the creditors, at least in part. The method of paring back the creditors' rights is somewhat ingenious in its simplicity: the natural person with all of said person's assets is replaced by a virtual replica with only limited assets; the natural person and the virtual replica are treated as completely distinct legal entities. This power shift unleashed economic entrepreneurship visible on dramatic scale almost ever since the days of the British East India Company.[*32]

However, creditors were not ready or willing to give up easily. Not only was the stigma of insolvency kept alive, as it still is nowadays, thereby pushing the debtor into a defensive role, but law was, moreover, more often than not used to recapture the natural person behind the fictitious debtor, returning that person to the liability system. Accordingly, it is only a slight exaggeration to say that, for instance, in Germany there is almost no limited liability. To be sure, the GmbH (i.e., the private limited-liability company) is extremely popular and, accordingly, widespread, but when it comes to taking out a loan from a bank or another business partner, the unlimited liability of the natural person enters in by means of a surety, a guarantee, or the like, which has to be presented by the CEO or another member of the board.

But the struggle goes on even beyond this. The above-mentioned economic reasonableness experienced its most consistent realisation in the US when, after tentative steps in this direction since the middle of the 19th century, in 1978 the famous Chapter 11 was introduced in the new Bankruptcy Code. Since there was no requirement for the commencement of such proceedings – i.e., there was no need to prove the existence of a reason for initiation, such as overindebtedness of the debtor or its inability to pay debts as they fall due, these proceedings could be used by debtors to escape the creditors' grasp. And since Chapter 11 was designed to help the debtor rather than achieve the debtor's liquidation, this was a welcomed shift of power in the old game between creditors and debtors. Among the latter, the airline carriers were the most prominent ones that in the beginning happily and extensively made use of this newly gained option.[*33] This led to

28 Informative in this regard is Dirk Streuber. *Die Flucht des Schuldners und die Reaktionstechniken eines Gesamtvollstrekkungsrechts – der fallitus fugitivus als Rechtsproblem*, Berlin 2014. – DOI: https://doi.org/10.1515/9783110340969.

29 Interestingly enough, this term reappears on occasion even today, when a debtor migrates from one EU member state to another for getting a better discharge option. The branding of this use of guaranteed freedom as flight – rather than forum shopping – reminds one of a basic understanding according to which in late Antiquity peasants (and others) were legally bound to the soil, *glebae adscripti*, in aims of safeguarding the state's or municipality's tax income.

30 JGR (Zepos) I 214f; Alexander Dölger, Reg. 656.

31 On this, see Wim Decock. 'Law, religion, and debt relief: Balancing above the "Abyss of Despair" in early modern canon law and theology'. *American Journal of Legal History* 2017(57), pp. 125–141. – DOI: https://doi.org/10.1093/ajlh/njx003.

32 Per Alberto Mazzoni & Maria Chiara Malaguti. *Diritto del Commercio Internazionale*, 2019, p. 10.

33 Cf. the current 'good-faith' requirement, under §§ 1112(b) and 1129(b)(3) BC. On this, see, for instance, In re Integrated Telecom Express, Inc., 384 F.3d 108 (3rd Cir. 2004); In re Liberate Technologies, 314 B.R. 206 (Bankr. N.D. Cal. 2004).

deliberations about the need for alignment between such areas, seeming mutually distant at first blush, as competition law and insolvency law.[*34]

Things are somewhat different outside the United States; the approach there whereby insolvency law is seen as a tool to provide the debtor with a second chance was quite unique and revolutionary in the 1970s and 1980s, in light of the strong tradition of the stigma of insolvency. Yet the debtor-helping model of Chapter 11 became copied almost all over the globe.[*35] The latest step visible right now in this direction is the European Directive 2019/1023 on the Preventive Restructuring Framework. Whereas other member states of the EU, such as the UK, France, Spain, and Poland, have little difficulty in offering a tool that only the debtor can trigger, precisely this element gave rise to heated debate in Germany.[*36] There, fear of the abuse potential is enormous and led to intense discussion about how to ring-fence this possibility. Seen from the historical perspective, this discussion was just a continuation of the time-honoured and, thereby, subcutaneous equation of the bankrupt with a culprit. And this discussion only echoed the one that emerged some decades ago in the context of the introduction of a discharge. In nearly millennia-old traditions, discharge was subject to the statute of limitations; in most cases, a generation (i.e., 30 years) had to pass before a debtor would be freed from the obligations. Now, the above-mentioned EU directive insists on a three-year period uniformly across all member states of the EU.

In sum, the historical development of the last two or three centuries reveals a considerable power shift in favour of the debtor. Limited liability, a rescue option rather than mandatory liquidation, and a short discharge period add up to fostering of entrepreneurship (indeed, the explicit purpose of the US and of the UK insolvency law), which is indicative of the contemporaneous economisation of life in general.

### (b) Creditors react

Not too long ago, the debtor–creditor tango saw yet another twist. It is one that evolved from something as deeply rooted and essential as freedom of contract and the associated private autonomy (*Privatautonomie*). Based on the idealistic assumption that there is a level playing field for both the creditor and the debtor, this doctrine is a concept as grand as it is idealistic: two parties agree on their announced offer and acceptance, and they are henceforth bound by their promises. However, reality in day-to-day life is a bit more nuanced: namely, upon closer inspection, the terrain of that playing field appears to be rather hilly if not mountainous. In terms of power, it is a matter of fact that regularly one party is superior to the other, be it intellectually, in terms of need, or with regard to whatever other circumstances or properties might obtain. Therefore, it has always been that the stronger party has seen private autonomy as a chance to improve its position in that relationship. General terms of contract are but one quintessential example of this: they were a welcomed tool to shift burdens unilaterally to the other party. It took President Kennedy's initial spark to ignite consumer-protection law, which is designed to reorder the power distribution among parties to contracts with regard to, *inter alia*, the fair use of those general terms.

Outside the realm of general terms of contract and beyond cutting back their effect on consumers, the idea of making use of contract clauses for one's own benefit not only remained alive but prospered considerably; under the name of 'covenants', these clauses nowadays enjoy widespread, even global use. Hence, whereas academic textbooks usually teach the students that a loan contract obliges the lender to transfer the promised amount of money to free disposability by the borrower, who, in turn, is obliged to pay interest and to return the amount received to the lender at the promised time, reality looks quite different: covenants impose all sorts of additional obligations on the borrower, which extend from reporting duties through business decisions and even to offering positions on the supervisory board to the lender's staff. In group contexts, these obligations might become quite expansive. In terms of the topic of this paper, every additional obligation imposed by the creditor on the debtor increases the creditor's powers implicitly.

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[34] See Christoph Paulus. 'Competition law vs. insolvency law: When legal doctrines clash'. *Uniform Law Review* 2013, p. 65 ff. – DOI: https://doi.org/10.1093/ulr/unt002.

[35] Deliberations about the reasons for this astonishing fact have been offered by Christoph Paulus. 'Ausdifferenzierungen im Insolvenz- und Restrukturierungsrecht zum Schutz der Gläubiger'. JZ 2019, p. 11 ff. – DOI: https://doi.org/10.1628/jz-2018-0280.

[36] Cf. Christoph Paulus. 'Die Einbettung des präventive Restrukturierungsrahmens in ein breiteres Umfeld' in Clemens Jaufer et al. (eds), *Unternehmenssanierung mit Auslandsbezug*, 2019, pp. 3, 10 ff.

And it is exactly at this point where things get somewhat obscure but are in actuality very real at the same time: Nowhere openly acknowledged, let alone discussed, a notion spreads rumour-like in undercurrents suggesting a rather unpleasant scenario: weaponisation of financial instruments. This term, allegedly coined in the early 1990s on Wall Street, seems to point to the drafter's intent to use a specific contractual relation as a tool to defeat or conquer the counterparty. It is no wonder that nobody describes exactly what is meant by this term.[*37] Still, the phenomenon is not, in fact, a new one as such. It has always been part of the power game that short-term as well as long-term strategies are pursued by those entering into a contractual relationship with someone else. What might possibly be new, however, is the method: it is no longer a singular advantage that is sought – a tactical move, as it were. There is now an obvious change into a strategy or into a business model.

So far, I have been able to discover just two forms in which such weaponisation appears, though others might be (or, rather, are likely to) exist.[*38] In both, the creditor has an interest in the debtor going bankrupt. Most definitely, it has always been the case that the creditors of a given debtor have widely differing interests: one might be interested in establishing a long-term relationship while another just wants rapid fulfilment of its claim, workers have different ideas than the lending bank, etc. However, the primary interest of none of those traditional creditors is in having the common debtor entering, let alone being pushed into, insolvency proceedings. But it is exactly this toward which those creditors aim when they pursue a 'loan to own' strategy or when they are 'secured' by a credit-default swap (CDS). A brief description of both contract types follows.

The loan-to-own strategy is based on the existence of a secondary market for non-performing loans plus the option of a debt/equity swap.[*39] Investors search for companies that are viable but in financial difficulties. In the secondary market, they buy claims[*40] against the target company for a discount. Once they have collected a sufficient amount this way, they make use of the power usually conferred on them by the covenants that come along with the freshly acquired claims. Thereby, they keep the management so busy that the daily economic operations begin to suffer, so the company is driven still closer to the brink of insolvency. It is usually then that the investor begins to talk about a debt/equity swap, which can be done either on a voluntary basis or by means of a restructuring[*41] or insolvency procedure. When this is done 'properly', the only option for the current owners and board members is the liquidation of the company. Should they decide against this, the loan-to-own strategy might result in no less than a takeover in the guise of restructuring or insolvency proceedings.

Whereas the loan-to-own strategy more often than not is intended to make use of or even to improve the viability of the company, the CDS's primary aim is just the debtor company's insolvency (no matter whether the outcome is liquidation or reorganisation). The CDS is a hybrid between loan collateral and an insurance contract.[*42] A creditor buys the right to claim from a third party (the seller) compensation in an agreed-upon amount when and if the buyer's claim suffers non-performance from the debtor due to default. Here, when and if the amount to be paid by the seller is larger than what the buyer would receive in the event of full performance by the debtor, there is a strong incentive on the creditor's (buyer's) part to see the debtor enter default and go bankrupt. One need not point out that a CDS-holder's manner of

37 But see Rebecca Harding. *The Weaponization of Trade: The Great Unbalancing of Politics and Economics*, 2017; Clifford Bob. *Rights As Weapons: Instruments of Conflict, Tools of Power*, 2019. – DOI: https://doi.org/10.1515/9780691189055; Mark Galeotti. *Weaponisation of Everything*, 2022, p. 140 ff. – DOI: https://doi.org/10.12987/9780300265132.

38 Credit bidding might be an additional appearance of this phenomenon; on this, compare Christoph Paulus & Nicholas R. Palenker. 'Mit Krediten bieten – Credit Bidding: Überlegungen zum Selbsteintrittsrecht der Gläubiger nach § 168 ABS'. ZInsO 2020(3), Wertpapier-Mitteilungen (WM), p. 1181 ff.

39 Addressed comprehensively by Nicholas R. Palenker. *Loan-to-own, Schuldenbasierte Übernahmen in Zeiten moderner Restrukturierungen und mangelnder Gläubigertransparenz*, 2019. – DOI: https://doi.org/10.5771/9783845299594; D. Baird & R. Rasmussen. 'Antibankruptcy'. *The Yale Law Journal* 2010(119), p. 648 ff.; Donald S. Bernstein. 'Toward a new corporate reorganisation paradigm'. *Journal of Applied Corporate Finance* 2007(19)/4, p. 8 ff. – DOI: https://doi.org/10.1111/j.1745-6622.2007.00156.x.

40 When the strategy is initiated only after the respective company's insolvency, the search for other creditors of this debtor has recently been alleviated by the Landgericht (District Court) of Munich: it decided that a creditor who had become a creditor by a purchase on the secondary market has the right to inspection of the creditor list set up by the insolvency administrator, per a decision of 9.9.2019 – 14 T 10502/19. See *Zeitschrift für Wirtschaftsrecht* (ZIP) 2020, p. 230.

41 Note that the EU's new Directive 2019/1023, on, i.e., a preventive restructuring framework, provides for such a possibility.

42 A notion treated comprehensively by Kenny Koa. *Gläubiger ohne Risiko: Der Empty Creditor im deutschen Insolvenzrecht*, 2020. – DOI: https://doi.org/10.5771/9783748905509; Angeliki Mavridou. *Credit Default Swaps in Bankruptcy Proceedings under US Law*, 2016. – DOI: https://doi.org/10.5771/9783845283470.

using the voting right granted to each and every creditor of an insolvent debtor in insolvency proceedings is powered by motivation that differs from that of almost all other traditional creditors; the CDS-holders are therefore also called 'empty creditors',[*43] since they have severed the connection between liability and dominion.

It should be mentioned here, though only as an aside, that this phenomenon of weaponisation of financial instruments is almost certainly not confined to private-law contracts; there is no reason not to assume that sovereigns too are interested in instrumentalising this method of modern[*44] warfare. Certain indications suggest that this horrifying scenario is already well on its way to actualisation.[*45]

## 3. *Résumé du développement*

After our tour through the historical development of the power game between creditors and debtors, we have reached a place to stop and summarise the observations and to draw some conclusions: Western legislation and common thinking seem to have accepted throughout that the creditor is automatically in the stronger position. The example of the ancient Middle East and the Old Testament, however, provides impressive evidence that this is by no means a God-given necessity.

In the Western world, centuries passed before the law reached out its helping hand to a debtor who could not fulfil his obligations. It was only in the time of Emperor Augustus that debtors were allowed to initiate insolvency proceedings. Before that, they were merely subjected to a procedure and had to suffer either being cut into pieces or losing not only their goods and assets but also their civil dignity. A few centuries after the time of Augustus, revenge-orientation took over again and inflicted on the debtors a wide range of sanctions beyond distribution of their assets, stretching from public shaming to debtors' prison and even to capital punishment.

A counter-movement came not from religious or ethical sources but from economic insights in the times of the origins of nation-states. Both the French-style *dirigisme* and the free-trade attitude of the English pointed to the wealth-maximisation potential of entrepreneurship, thus paving the way for the development of limited liability as protection for the debtor. The complexity of modern corporate and company law is the blossom of that little flower that was planted in the times of the East India Company. It has grown into modern insolvency law that includes the option of the debtor's rescue and guarantees debt-freeness after a rather short span of time.

The most recent reaction from the creditor's side is instrumentalisation of private autonomy. This manifests itself in the form of so-called covenants and conceding all manner of rights to the creditor. It is almost logical that this latest twist brings the power game nearly back to its starting point from around 450 BC: In the times of the notorious Twelve Tables legislation of ancient Rome, the creditors were allowed to kill the debtor. Today, freedom of contract does not constitute an impediment when and if the creditors wage a war against the debtors by means of a contract (neither does public international law contradict this with its prohibition of 'the use of force' in Art. 2(4) of the Charter of the United Nations[*46]). Admittedly, we are not talking about physical harm, but the ruin of the other side is the goal in both settings.

In light of this evolution running full circle and bringing back what appeared to have been overcome forever, a reminder for the legislator seems to be in order. The most noble task of the law has always been,

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43 See, for instance, H. Hu & B. Black. 'The new vote buying – empty voting and hidden (morphable) ownership'. *Southern California Law Review* 2006(79), p. 811 ff.; H. Hu. 'Equity and debt decoupling and empty voting II – importance and extensions'. *University of Pennsylvania Law Review* 2008(156), p. 625 ff. – DOI: https://doi.org/10.2139/ssrn.1030721.

44 Again, the phenomenon is old: US President John Adams (1797–1801) once said: 'There are two ways to enslave a country. One is by the sword, the other is by debt.' What appears to be new is the systematisation of the possibilities.

45 See Mark Galeotti. *Weaponisation of Everything* (see Note 37); Christoph Paulus. 'Von zahlungsunfähigen Staaten und tickenden Bomben'. *Zeitschrift für Rechtspolitik* (ZRP) 2018, p. 151 ff.; Juan Zarate. 'Conflict by other means: The coming financial wars'. *Parameters* 2013(43)/4, pp. 87–97; David J. Katz. 'Waging financial war', available via https://press.armywarcollege.edu/parameters/vol43/iss4/24/; Anna Gelpern. 'Russia's contract arbitrage'. *Capital Markets Law Journal* 2014(9), p. 308 ff. – DOI: https://doi.org/10.1093/cmlj/kmu012; Uri Friedman. 'Smart sanctions: A short history', available at http://foreignpolicy.com/2012/04/23/smart-sanctions-a-short-history/.

46 But see, for example, Lee C. Buchheit. 'The use of nonviolent coercion: A study in legality under Article 2(4) of the Charter of the United Nations' in Richard B. Lillich (ed.), *Economic Coercion and the New International Economic Order*, 1976, p. 41 ff.

still is, and presumably forever will be to protect the weak. Law will, at the same time, always be used by the shrewd as a means to win the power game. Therefore, this very law has to react and outbalance such unilateral usurpation of power. If or when we find ourselves back where we were in 450 BC, it would merit taking time to look at the much more human model of power distribution in the Near East jurisdictions.[*47]

This is all the more true in the shadow of our most recent experiences of such global disasters as a pandemic: a cataclysm of this nature is bound to lead to many insolvencies because people, private ones as well as those in the business domain, cannot (or soon will be unable to) pay their bills.[*48] To survive, they have to borrow money, which creates an enormous burden for any fresh start after the global disaster recedes.[*49] Any legislator would be well advised to study those ancient Middle Eastern concepts carefully.

47 This task has an egregious dimension in the context of sovereigns as debtors; see Christoph Paulus. 'Warum benötigen wir ein Resolvenzverfahren?'. ZIP 2019, p. 637 ff.

48 What is needed is a 'bad weather' insolvency law; with regard to this, see Christoph Paulus. 'Gutwetter-Insolvenzrecht und Schlechtwetter-Insolvenzrecht: Über die ökonomischen Grundbedingungen des Insolvenzrechts.' ZIP 2016, p. 1657 ff.; Christoph Paulus. 'Der Solidargedanke als Grundlage des Katastrophenrechts – Lehren aus der Pandemie'. JZ 2021, p. 931 ff. – DOI: https://doi.org/10.1628/jz-2021-0318.

49 Additionally, this might lead to a new increase in non-performing loans, which, in turn, might burden banks. When they start to stumble, history and most recent experiences with the euro crisis teach, states too are endangered; see Christoph Paulus. 'Euroland'. *South Square Digest* 2020/June.