Expert Report
Gerloff v. Hostetter Schneider Realty et al.
1:12-cv-09404-LGS
in regard to: Motion to Dismiss the Amended Complaint
-- Issues of German Insolvency Law --

Part 0

General Facts
Stated in the Amended Complaint
With Respect to Both Defendants

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I. Insolvency Proceedings

1. Against Escada AG

Petition by the debtor (Escada AG) under the German Insolvency Act (in German: "Antrag auf Eröffnung des Insolvenzverfahrens"): Aug. 13, 2009 (Amended Complaint ¶ 11)

Order of relief under the Insolvency Code (literally translated from German: "opening" of the insolvency proceedings): Nov. 1, 2009

2. Against Escada USA

Petition by the debtor (Escada USA) under Chapter 11 of the B.C.: Aug. 14, 2009

In January 2010, it was decided to assume (within the meaning of § 365 (a) B.C.) the Owner-Manager Agreement entered into between Escada USA and Defendant HS Asset and to assign this contract to a third-party purchaser of Escada USA's assets. (Defendants, Memorandum, May 15, 2013, Document 13, p. 6; not stated in the Amended Complaint, but potentially judicially noticeable, Letter of Judge Schofield to me, Jan. 14, 2014.)

II. The Payment

BiBA GmbH ("BiBA") was, in June 2009, a wholly-owned subsidiary of Escada AG. On June 5, 2009, Escada AG entered into a contract with GELCO GmbH & Co KG ("Gelco") to sell all of its shares in BiBA to Gelco (Amended Complaint ¶ 8).

Not stated in the Amended Complaint; hence not used in my Report:

> The purchase price agreed upon (by Escada AG and Gelco) was EUR 10 million. The lion's share of this sum (EUR 9 million) was attributed to the release of BiBA from "intra-group liabilities" (Lüke Expert Report, filed July 25, 2013, Document 24, p. 6). This term seems to refer to the guarantee BiBA had given to certain creditors of Escada AG ("Guarantee"), and from which BiBA was released by, or along with, the sale (of Escada AG's shares in BiBA) to Gelco.

In 2005 Escada AG had issued a bond over EUR 200 million ("Bond"). Certain subsidiaries of Escada AG, including BiBA, guaranteed its repayment. The covenants of the Bond stipulated the conditions under which the guarantee given by a guarantor subsidiary (such as BiBA) would end. If a guarantor subsidiary is sold by Escada AG, it will be released from its guarantee, provided that the proceeds which Escada AG will receive from the sale will be deployed in a manner permitted by the covenants of the Bond (Lüke Expert Report, filed July 25, 2013, Document 24, p. 6: "permitted utilization purposes").

Escada AG directed Gelco to pay certain parts of the purchase price not to it (Escada AG), but to various third parties ("creditors and other parties") named by Escada AG. One of these third parties was Defendant Pier (Amended Complaint ¶¶ 9-10).

Escada AG directed Gelco to pay EUR 1,621,126.76 (the "Funds") to Pier (Amended Complaint ¶¶ 9-10). Accordingly, on July 24, 2009, Gelco transferred the Funds to a U.S. bank account maintained by Pier (the "Payment") (Amended Complaint ¶¶ 9-10).

Plaintiff states that this bank account was maintained at Compass Bank (Amended Complaint ¶ 10). (The Defendants allege a different bank, The Savannah Bank; March 7 Letter, document 23-1, filed July 24, 2013, pdf-p. 3; but this difference does not appear to be material.)

Not stated in the Amended Complaint:

The Defendants state that the account, to which the Funds were credited, was an escrow account titled "MB Hostetter / Hugh Armstrong Real Estate Trust / Escrow Account" at The Savannah Bank (March 7 Letter, document 23-1, filed July 24, 2013, pdf-p. 3).

III. Relationship Between Escada AG and Pier

Plaintiff pleads alternative fact situations with respect to the relationship between Escada AG and Pier, depending on the Defendant.

IV. Role of HS Asset

Defendant HS Asset is a subsidiary or affiliate of Pier (Amended Complaint ¶ 5).

Plaintiff pleads alternative facts as regards the role of HS Asset, depending on the Defendant.

Question 1: § 131 German Insolvency Act

What are the elements of a claim under Section 131(1) of the German Insolvency Law? Does Plaintiff's [Amended] Complaint state a claim for relief under Section 131(1) of the German Insolvency Law?

Note to Judge Schofield: Turning away from ¶ 12 (Pier) and ¶ 15 (HS Asset) of the Amended Complaint, Plaintiff no longer seeks relief under § 131 German Insolvency Act (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-p. 9, footnote 3).

Report on Question 1

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A. § 131 German Insolvency Act: Requirements

German avoidance law, like American avoidance law, has two branches: avoidance because of misconduct of the debtor against its creditors (in the U.S.: law of fraudulent conveyances), and avoidance because of misconduct of one creditor against the other creditors (in the U.S.: preference law).[1]

§ 131 German Insolvency Act belongs to the second branch (preference law). German preference law knows various statutory grounds of avoidance. The most important ones are: § 130 German Insolvency Act, which is the basic rule,[2] and § 131 German Insolvency Act, which is a variation on the basic rule.[3]

§ 131 German Insolvency Act has the following elements:

I. Transfer to a Creditor

§ 131 German Insolvency Act targets any transfer made to one of the debtor's creditors on account of an (antecedent) debt owed to this creditor and with the effect of performing or securing such debt.

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1 See Thole, Gläubigerschutz durch Insolvenzrecht, 2010, pp. 287-301; Thole, Die tatbestandlichen Wertungen der Gläubigeranfechtung, ZZP (Zeitschrift für Zivilprozess) 121 (2008) 67. Other authors employ different ordering principles, but I think the system argued for by Thole is the most convincing, and it corresponds with the legal doctrine in other countries. On U.S. law: Jackson, The Logic and Limits of Bankruptcy Law, 1986, pp. 68-69, 123-124, 146-148; Baird, The Elements of Bankruptcy, 5th edition 2010, chapter 7 (fraudulent conveyances), chapter 8 (preferences). English law: Keay, In Pursuit of the Rationale Behind the Avoidance of Pre-Liquidation Transactions, (1996) 18 Sydney Law Review 55 (at 59) (all authors emphasizing the differences between a fraudulent conveyance and a preference).

2 § 130 German Insolvency Act roughly parallels Section 547(b) B.C., excluding, however, the exemption of preferences made in the ordinary course of business (Section 547(c)(2) B.C.). As opposed to its American counterpart, § 130 German Insolvency Act has subjective requirements such as the preferred creditor's awareness of the debtor's insolvency at the time of the transfer.

3 § 131 German Insolvency Act roughly parallels Section 547(b) B.C., including the exemption of preferences made in the ordinary course of business (Section 547(c)(2) B.C.). As opposed to its American counterpart, § 131 German Insolvency Act has a narrower understanding of the "ordinary of course of business"; exempted are only those transfers which reflect arrangements that were made within the specific contractual relationship.

II. Preference

The transfer must result in a "preference": Through the transfer the creditor received more than the creditor would have received if insolvency relief had already been ordered at the time of the transfer.

This requirement cannot be found in the texts of §§ 130 and 131 German Insolvency Act. But there is a general consensus among legal authorities that the preference, as measured against the distributional rules that will apply in the subsequent insolvency proceeding, is the reason for the transfer being voidable. §§ 130 and 131 German Insolvency Act thus extend the rule of pro-rata distribution, applicable to the unsecured creditors in the insolvency proceeding, into the three-months period preceding the insolvency petition.[4]

III. Incongruence (Discrepancy) of the Transfer With the Contractual Arrangements

§ 131 German Insolvency Act covers only those transfers that deviate from the contractual arrangements of the debtor and the creditor. This deviation is meant by the term "incongruence" used in the heading of § 131 German Insolvency Act.

(Transfers made as provided for in the contractual arrangements, and thus in "congruency" with the contractual arrangements, are outside § 131 German Insolvency Act. They are covered by § 130 German Insolvency Act.)

IV. Additional Requirements Depending on the Time Period

§ 131 German Insolvency Act differentiates between various time periods (within the three-month reach-back period) and states different additional requirements, depending on the time period. In the present case, we are in the time period of no. 1: The transfer was made within one month before the insolvency petition. (The Payment was made on July 24, 2009; the petition was filed on Aug. 13, 2009.) For this time period no additional requirements apply.

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4 E.g. Häsemeyer, Insolvenzrecht, 4th edition 2007, ¶ 21.38.

V. Reach-Back Period

§ 131 German Insolvency Act may reach preferences an unsecured creditor received within three months prior to the insolvency petition.

VI. English Translation

The English translation of § 131(1) German Insolvency Act published on the Web site of the (German) Federal Ministry of Justice reads:

"Section 131 - Incongruent Coverage

(1) A transaction granting or facilitating a creditor of the insolvency proceedings a security or satisfaction without his entitlement to such security or satisfaction, or to the kind or date of such security or satisfaction, may be contested if such transaction was made

1. during the last month prior to the request to open insolvency proceedings or after such request;

2. within the second or third month prior to the request to open insolvency proceedings, and the debtor was illiquid on the date of the transaction; [or][5]

3. within the second or third month prior to the request to open insolvency proceedings, and the creditor was aware of the disadvantage to the creditors of the insolvency proceedings arising from such transaction on its date.

(2) . . . "

In our case we will only need § 131(1)(No. 1) German Insolvency Act.

B. Amended Complaint Statement of a Claim for Relief Under Section 131 of the German Insolvency Act?

Does Plaintiff's Amended Complaint state a claim for relief under Section 131(1) of the German Insolvency Act?

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5 Missing in the Ministry's translation.

The Amended Complaint is directed against two defendants and states alternative fact situations, depending on the defendant. Each defendant, with the corresponding fact situation, will be considered in turn.

My Report will arrive at the conclusion that Plaintiff's Amended Complaint, in the applicable factual scenario pleaded by Plaintiff, states the requirements of § 131(1) German Insolvency Act for each Defendant (Pier and HS Asset).

I. Defendant Pier (§ 131 German Insolvency Act)

1. Factual Assertions of the Amended Complaint (Defendant Pier, § 131 German Insolvency Act)

As regards Defendant Pier, Plaintiff states the following fact situation, in addition to the "General Facts" (summarized in Part 0 of this Report):

(I) Insolvency Proceedings

-- Part 0 "General Facts"

(II) The Payment

-- Part 0 "General Facts"

(III) Relationship Between Escada AG and Pier

Pier was a creditor of Escada AG (Amended Complaint ¶ 12).

The Amended Complaint does not state any details of the relationship between Pier and Escada AG; in particular there is no information on the debt that was allegedly owed by Escada AG to Pier (and that was performed by the Payment). I presume that the Amended Complaint may be interpreted to state that Escada AG's debt to Pier was unsecured. Furthermore, I assume that the Amended Complaint may be understood to state that in the relationship between Pier and Escada AG there was no contractual agreement that required Escada AG to effect the payment owed to Pier by instructing Gelco to pay to Pier.

(IV) Role of HS Asset

The Amended Complaint seems to state that Defendant Pier, and not Defendant HS Asset, was the beneficiary of the Payment, and, in particular, did not act as a conduit for HS Asset (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-pp. 14 and 15).[6]

2. Legal Opinion
(Defendant Pier, § 131 German Insolvency Act)

In the factual alternative under review (Pier a creditor of Escada AG; Pier the beneficiary of the Payment), the Amended Complaint states a claim of relief under § 131 German Insolvency Act against Defendant Pier.

The requirements of § 131(1) German Insolvency Act are met:

The Payment was made to a "creditor". It performed a debt owed to Pier by Escada AG.

The Payment constituted a "preference": It enabled Pier to receive more than Pier would have received had the insolvency proceeding against Escada AG already been opened at the time of the Payment. In the insolvency proceeding, Pier, an unsecured creditor, would only have received a pro rata payment on the debt owed to it by Escada AG.

German courts would deem the Payment to be "incongruent". I think it can be assumed that, in the scenario stated in the Amended Complaint, there was no contractual agreement between Pier and Escada AG to the effect that the payment due from Escada AG had to be made by instructing Gelco to pay to Pier. If this assumption is correct, the Payment took a path that had not been outlined in the contractual relationship between Pier and Escada AG. The payment that would have been expected within the contractual relationship was a bank transfer directly from Escada AG to Pier. By taking a different path, namely via Gelco, the Payment deviated from this expectation. In German insolvency jurisprudence, any deviation from the modes of payment provided for in the contract is viewed as a signal warning the receiving creditor that the payment might constitute a pre-insolvency preferential treatment. That the debtor (Escada AG)

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6 The factual assertions are to be determined by American law of civil procedure, with which I am not familiar. In ¶ 12 of the Amended Complaint the issue who was the beneficiary of the payment is not expressly addressed.

does not pay by a direct bank transfer, but rather instructs one of its debtors (Gelco) to carry out the payment to the creditor (Pier), is generally accepted to constitute such a deviation and thus to be “incongruent”.[7]

No further requirements apply, because the Payment was made within one month prior to the insolvency petition (no. 1 of § 131(1) German Insolvency Act).

3. Additional Comment

In this factual scenario (Pier a creditor of Escada AG, Pier the beneficiary of the Payment), the Payment would also be voidable under § 133(1) German Insolvency Act.

II. Defendant HS Asset (§ 131 German Insolvency Act)

1. Factual Assertions of the Amended Complaint (Defendant HS Asset, § 131 German Insolvency Act)

As regards Defendant HS Asset, Plaintiff states the following fact situation, in addition to the “General Facts” (summarized in Part 0 of this Report):

(I) Insolvency Proceedings

-- Part 0 “General Facts”

(II) The Payment

-- Part 0 “General Facts”

(III) Relationship Between Escada AG and HS Asset

HS Asset was a creditor of Escada AG (Amended Complaint ¶ 18).

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7 E.g.: Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Volume 4, 2008, § 131 ¶ 15; Kübler/ Prütting / Bork (Brinkmann), Insolvenzordnung, Kommentar, looseleaf, 2013, Anhang I zu § 145 ¶¶ 27-28.

The Amended Complaint does not state any details of the relationship between HS Asset and Escada AG; in particular there is no information on the debt that was allegedly owed by Escada AG to HS Asset. I presume that the Amended Complaint may be interpreted to state that Escada AG's debt to HS Asset was unsecured. Furthermore, I assume that the Amended Complaint may be understood to state that in the relationship between HS Asset and Escada AG there was no contractual agreement that required Escada AG to effect the payment owed to HS Asset by instructing Gelco to pay to HS Asset via Pier.

(IV) Role of Pier

Pier transferred the Funds to HS Asset (Amended Complaint ¶ 15).

The Amended Complaint (¶ 15) does not state the reason for this transfer (from Pier to HS Asset). It is for American law (of civil procedure) to decide whether the Amended Complaint may be interpreted to state that, in this fact scenario, Pier, when receiving the Funds from Escada AG (via Gelco), acted as a fiduciary of HS Asset. I assume that this interpretation will be permissible.

2. Legal Opinion
(Defendant HS Asset, § 131 German Insolvency Act)

In the factual alternative under review (HS Asset a creditor of Escada AG; HS Asset the beneficiary of the Payment), the Amended Complaint states a claim of relief under § 131 German Insolvency Act against Defendant HS Asset.

The reasons are the same as stated in part B I 2 (§ 131 German Insolvency Act against Pier) of this Report on Question 1.

3. Additional Comment

In this factual scenario (HS Asset a creditor of Escada AG, HS Asset the beneficiary of the Payment), the Payment would also be voidable under § 133(1) German Insolvency Act.

Question 2: § 134 German Insolvency Act

What are the elements of a claim under Section 134 of the German Insolvency Law? Does Plaintiff's [Amended] Complaint state a claim for relief under Section 134 of the German Insolvency Law?

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A. § 134 German Insolvency Act: Requirements

§ 134 German Insolvency Act declares any transfer made, and any obligation incurred, by the future insolvency debtor to be voidable, if the future insolvency debtor either received nothing in exchange ("no consideration") or received less than an equivalent value in exchange ("no equivalent consideration"). Such "gratuity" is considered a (grave) misconduct of the future insolvency debtor against the creditor body, provided that the debtor is insolvent or will become insolvent within four years.[8]

German jurisprudence developed various tests which may establish "gratuity" within the meaning of § 134 German Insolvency Act, three of which may be applicable in the present litigation.

I. Tests for "Gratuity"

1. Basic Test: The Contract

Under the basic test, the requirement "no consideration" or "no equivalent consideration" is determined by the contract which the parties to the transaction (the avoidance is which is being sought) have entered into with respect to the transaction and which governs the transaction.

As regards the "no consideration" variant, the parties must have agreed that the other party does not owe any obligation to the debtor in exchange for the obligation incurred by the debtor or the transfer made by the debtor.

As regards the "no equivalent consideration" variant, the starting point, again, is the agreement reached by the parties: Their agreement does stipulate an obligation of the other party as a consideration for the transfer or obligation of the future insolvency debtor, but this consideration is not of equivalent value to the obligation incurred, or transfer made, by the future insolvency debtor. The parties do not need to know, however, that the consideration promised by the other party is not of equivalent value.

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8 This ground of avoidance roughly parallels Section 548(a)(1)(B) B.C. As opposed to its American counterpart, § 134 German Insolvency Act does not require that the future insolvency debtor was insolvent at the time of the transaction or became insolvent because of the transaction.

The reference to the contract is the basic test for § 134 German Insolvency Act ("Basic Test"), and it appears to be unanimously accepted among courts and legal writers.[9]

That it is the agreement that matters and controls the issue of "gratuity" is emphasized by the Lüke Expert Report, too. In its original German version it states that the transfer of an asset is deemed "gratuitous" if *pursuant to the agreement* the transferee is not required to give an (adequate) consideration in return.[10] The phrase "pursuant to the agreement" (German: "vereinbarungsgemäß") did not find its way into the English version.[11] It is not decisive, as the English version might imply, that no consideration was in fact given by the transferee. Rather it is essential, that the agreement between the parties provides that the transferee does not owe anything in return.[12]

2. Special Test 1: Unjust Enrichment Situations

Another case of "gratuity" is related to the law of unjust (or more precise: unjustified) enrichment. Where a benefit was transferred and this transfer was not supported by a contract or another legal basis, the transferor, under the law of restitution and unjust enrichment, is entitled to recover the benefit conferred from the transferee (in German law: § 812 Civil Code). According to the majority view among courts and legal authors, the unjustified enrichment in itself is not an act voidable under § 134 German Insolvency Act, because the transferor's right to restitution prevents the transfer from being "gratuitous".[13] The picture changes, however, where

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9 Sample: Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Volume 4, 2008, § 134 ¶¶ 9-10; Münchener Kommentar zur Insolvenzordnung (Kayser), 3rd edition, Volume 2, 2013, § 134 ¶¶ 17, 19, 22; Heidelberger Kommentar zur Insolvenzordnung (Kreft), 6th edition 2011, § 134 ¶¶ 7-8 and 10; Kübler / Prütting / Bork (Bork), Insolvenzordnung, Kommentar, looseleaf, 2013, § 134 ¶¶ 39-40. -- These commentators cite the relevant case law of the Bundesgerichtshof (Federal Court of Justice).

10 Lüke Expert Report, filed July 25, 2013, Document 24, German version, pdf-p. 42.

11 Lüke Expert Report, filed July 25, 2013, Document 24, English version, p. 10: "and where there *is* no recompense from the third-party receiving the benefit" (emphasis added).

12 See Heidelberger Kommentar zur Insolvenzordnung (Kreft), 6th edition 2011, § 134 ¶ 10.

13 Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Vol. 4, 2008, § 134 ¶¶ 12, 13; Häsemeyer, Insolvenzrecht, 4th edition 2007, ¶ 21.92; Nerlich / Römermann (Nerlich), Insolvenzordnung – Kommentar, looseleaf, 2013, § 134 ¶ 34; Uhlenbruck / Hirte / Vallender (Hirte), Insolvenzordnung – Kommentar, 13th edition 2010, § 134 ¶ 36; Thole, Grundfragen und aktuelle Problemstellungen der

the transferor was aware that the transfer would be without a legal basis and, despite of this knowledge, carried out the transfer. In this situation the transferor has forgone its right to restitution: The transferor is not entitled, under the law of unjustified enrichment, to recover the benefit conferred (in German law: § 814 Civil Code). The loss of the right to restitution is deemed an act of "gratuity"[14] and thus voidable under § 134 German Insolvency Act. In consequence, the transferor's insolvency receiver may recover the benefit conferred, on the basis of § 134 German Insolvency Act.[15]

The special "unjust enrichment" test for § 134 German Insolvency Act has thus three elements:

(1) A benefit is transferred to a recipient;

(2) this transfer lacks an adequate legal, in particular contractual, basis;

and

(3) the transferor is aware of the lack of a legal ground, i.e. the transferor knows that there is no obligation to transfer the benefit to the transferee, and thereby foregoes its right to restitution.

3. Special Test 2: Payment to a Third-Party Creditor

Another special test (for § 134 German Insolvency Act) will be employed in the following fact situation: The future insolvency debtor (payor) makes a payment (or transfers any other asset) to a person (payee) who is not its creditor. Rather, the payee is the creditor of another person (third-party debtor). The payment (by the payor to the payee) serves to meet the debt incurred by the third-party debtor in its contract with the payee (third-party creditor). The payment (whose avoidance is being sought) thus does not track the contractual relationships

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Anfechtung unentgeltlicher Leistungen, in: KTS (Zeitschrift für Insolvenzrecht) 2011, 219 (at 224); Kübler / Prütting / Bork (Bork), Insolvenzordnung, Kommentar, looseleaf, 2013, § 134 ¶ 46.

14 See, e.g., Jaurnig (Stadler), Bürgerliches Gesetzbuch, 14th edition 2011, § 814 ¶ 1: Transfer made while knowing that no obligation exists is a case of „gratuity".

15 Bundesgerichtshof (Federal Court of Justice), Dec. 11, 2008, IX ZR 195/07, ¶ 13; July 18, 2013, IX ZR 198/10, ¶ 21; Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Vol. 4, 2008, § 134 ¶ 34; von Wilmowsky, Schneeballsysteme der Kapitalanlage, 2010, ¶¶ 125-140 and ¶¶ 151-160.

(from the payor to the third-party debtor and then from the third-party debtor to the third-party creditor), but cuts across them. There is no contractual relationship, or any other type of agreement concerning the payment, between the payor and the payee.

Under the Basic Test, the payor's insolvency receiver is prevented from bringing an avoidance action based on § 134 German Insolvency Act against the payee (because there is no agreement between payor and payee as to absence of any consideration, or to a less than equivalent consideration). The special test developed for payments of third-party debts ("Special Test") extends the reach of the § 134 German Insolvency Act remedy, by stating that the lack of a contractual relationship (or of any other type of agreement, regarding the payment) between payor and payee (the existence of which is of prime importance under the Basic Test) does not preclude an avoidance action based on § 134 German Insolvency Act against the payee. Instead, the focus is on the "true value" the right to payment, established by the contract between the payee (as third-party creditor) and the third-party debtor, had at the time of the payment. The controlling consideration is: What was, at the time of the payment, the true value of the payee's right of payment that was satisfied by the payment? If the true value corresponds with the amount paid, the test is failed; then an avoidance action based on § 134 German Insolvency Act does not lie against the payee. If, however, the value of the right of payment was depressed (due to, e.g., the insolvency of the third-party debtor) at the time of the payment, then (and only then) the avoidance remedy of § 134 German Insolvency Act will apply against the payee.[16]

(The following paragraph may be skipped. It will summarize the criticism of this Special Test.) From a theoretical point of view, the Special Test for transfers to third-party creditors appears to be misguided. This Special Test violates basic principles of both fraudulent conveyance law (in Germany: the law of avoidance because of debtor misconduct) and preference law (in Germany: the law of avoidance because of creditor misconduct). There is no reason why the involvement of more than two parties (the transferor and the transferee), as the payment of a third-party debt, should be treated differently from a two-party relationship. If the

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16 See, e.g., Bundesgerichtshof (Federal Court of Justice), March 3, 2005, IX ZR 441/00, ¶¶ 13-14; Bundesgerichshof (Federal Court of Justice), Nov. 26, 2007, IX ZR 194/04, ¶ 8. Further Bundesgerichtshof rulings are cited by: Münchener Kommentar zur Insolvenzordnung (Kayser), 3rd edition, Volume 2, 2013, § 134 ¶¶ 17a, 31-31c; Kübler / Prütting / Bork (Bork), Insolvenzordnung, Kommentar, looseleaf, 2013, § 134 ¶¶ 61-62; Thole, Gläubigerschutz durch Insolvenzrecht, 2010, pp. 461-464.

contract governs the question of "gratuity" (i.e. the lack of an adequate consideration) in the two-party constellation, the same should hold true for the multi-party situation.[17] The Special Test for third-party creditor transfers focuses on the distribution the payee (third-party creditor) receives on its right of payment (against the third-party debtor). If the payment by the future insolvency debtor gives the third-party creditor more than the latter would have received from the insolvent third-party debtor, than the payment is deemed a fraudulent conveyance (namely "gratuity"). By doing so, this Special Test employs the test that is typical of preference law: Did a creditor (here: the third-party creditor) receive more on its claim than it would have received if insolvency relief (on behalf of the third-party debtor) had already been ordered?[18] The Special Test (for transfers to third-party creditors) thus transplants an element of preference law into fraudulent conveyance law.[19] Given that these two branches of avoidance law are based on different principles, serve different legal purposes and had different historical developments, the mixing of requirements is not likely to produce sound results. Distinguished legal scholars thus call for abandoning the Special Test for payments to third-party creditors.[20]

But, to date, the Special Test (for payments to third-party creditors) is (still) good law. Had a German court to decide on the voidableness of Escada AG's Payment (under § 134 German Insolvency Act), it would in all likelihood apply the Special Test, if the Payment was made to a third-party creditor.

II. Reach-Back Period

§ 134 German Insolvency Act reaches transactions the debtor made within four years before the insolvency petition.

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17 Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Vol. 4, 2008, § 134 ¶ 25.

18 For American preference law see § 547(b)(5) B.C. In German preference law (§§ 130 and 131 German Insolvency Act) the same test applies, see Report on Question 1, part A II.

19 Thole, Gläubigerschutz durch Insolvenzrecht, 2010, pp. 463-464.

20 Most notably Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Vol. 4, 2008, § 134 ¶ 25. Opposed, too: Häsemeyer, Insolvenzrecht, 4th edition 2007, ¶ 21.92 and ¶ 21.93; Wazlawik, Dreiecksverhältnis und Doppelinsolvenz, NZI (Neue Zeitschrift für das Recht der Insolvenz und Sanierung) 2010, 881 (at 885-888); Kübler/ Prütting / Bork (Brinkmann), Insolvenzordnung, Kommentar, looseleaf, 2013, Anhang I zu § 145 ¶¶ 62-66; Bitter, Zahlungsmittler im Insolvenzanfechtungsrecht – Zur Anwendung der §§ 133, 134 InsO im Mehrpersonenverhältnis, in: Bankrechtstag 2013, 37 (at 81-89).

III. English Translation

The English translation of § 134 German Insolvency Act published on the Web site of the (German) Federal Ministry of Justice reads:

"Section 134 - Gratuitous Benefit

(1) A gratuitous benefit granted by the debtor may be contested unless it was made earlier than four years prior to the request to open insolvency proceedings.

(2) If such benefit comprises a usual casual gift of minor value the gift may not be contested."

IV. Additional Comment: No status as creditor required

Defendants argue that Plaintiff cannot recover from the Defendants, because under § 134 German Insolvency Act the insolvency receiver cannot recover from a "non-creditor" (Defendants, Memorandum May 15, 2013, Document 13, p. 9). This argument appears to be a misunderstanding of the Declaration Müller. Renate Müller correctly states that the avoidance remedy of *§ 131* German Insolvency Act applies to creditors only (Declaration Müller, May 5, 2013, Document 14, ¶ 7). As regards *§ 134* German Insolvency Act, however, Renate Müller does not mention such a requirement (cf. Declaration Müller, May 5, 2013, Document 14, ¶¶ 8-11), and correctly so: § 134 German Insolvency Act does not require that the defendant was a creditor (of the future insolvency debtor).

B. Amended Complaint: Statement of a Claim for Relief Under Section 134 of the German Insolvency Act?

Does Plaintiff's Amended Complaint state a claim for relief under Section 134 of the German Insolvency Law?

The Amended Complaint is directed against two defendants and states alternative fact situations, depending on the defendant. Each defendant, with the corresponding fact situation, will be considered in turn.

My Report will arrive at the conclusion that Plaintiff's Amended Complaint, in the applicable factual scenario pleaded by Plaintiff, appears to state the requirements of § 134 German Insolvency Act for Defendant Pier, but not for Defendant HS Asset.

I. Defendant Pier (§ 134 German Insolvency Act)

1. Factual Assertions of the Amended Complaint (Defendant Pier, § 134 German Insolvency Act)

As regards Defendant Pier, Plaintiff states the following fact situation, in addition to the "General Facts" (summarized in Part 0 of this Report):

(I) Insolvency Proceedings

-- Part 0 "General Facts"

(II) The Payment

-- Part 0 "General Facts"

(III) Relationship Between Escada AG and Pier

Pier was not a creditor of Escada AG (Amended Complaint ¶ 12).

No consideration was given or promised by Pier to Escada AG in exchange for the Payment (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-pp. 13-14).[21]

The Amended Complaint does not make any further statements on the relationship between Escada AG and Pier. Neither does it expressly state that the parties had reached an agreement regarding the Payment, nor does it expressly exclude such an agreement. How the Amended Complaint is to be interpreted, is for American law to decide (and therefore beyond the scope of this Report). However, in order to implement the tests relevant for § 134 German

21 This is not expressly stated in the Amended Complaint, but may be gained by interpreting the Amended Complaint.

Insolvency Act, the relationship between Escada AG and Pier is of critical importance. I therefore cannot avoid interpreting the Amended Complaint.

My interpretations (as regards Defendant Pier and § 134 German Insolvency Act) will be:

The Amended Complaint may not be interpreted to state that there was an agreement between Escada AG and Pier to the effect that Pier should receive the Payment without giving a consideration in return.

The Amended Complaint may be interpreted to state that the Payment (by Escada AG to Pier) lacked an adequate legal basis, and that Escada AG, when instructing the Payment, was aware of this absence of a legal basis. This assumption is favorable for Plaintiff, but may be justified in the present stage of the litigation.

(IV) Role of HS Asset

The Amended Complaint seems to state that Defendant Pier, and not Defendant HS Asset, was the beneficiary of the Payment and, in particular, did not act as a conduit for HS Asset (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-pp. 14 and 15).[22]

2. Legal Opinion
(Defendant Pier, § 134 German Insolvency Act)

While the Basic Test for § 134 German Insolvency Act appears to be failed (a) and the Special Test for third-party creditor payments is not applicable (b), the Special Test for unjust enrichment situations seems to be met (c).

a) Basic Test for § 134 German Insolvency Act

In order to meet the Basic Test for § 134 German Insolvency Act, Plaintiff's Amended Complaint has to assert that Escada AG and Pier had reached an agreement, pursuant to which

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22 The factual assertions are to be determined by American law of civil procedure, with which I am not familiar. In ¶ 12 of the Amended Complaint the issue who was the beneficiary of the payment is not expressly addressed.

either Pier does not owe any consideration to Escada AG in exchange for the Payment or the consideration which Pier does owe to Escada AG is of less value than the Payment.

I have no authority (and no competence) to interpret the Amended Complaint. Only for the purposes of this Report (on the German law issues), which make it inevitable to make factual assumptions, I will suggest the following interpretation: The Amended Complaint cannot be read to state an agreement on the "gratuity" of the Payment.

According to the Amended Complaint, there was no contractual relationship between Escada AG which initiated the Payment and Pier which received the Payment. The Amended Complaint does not state that any agreement had been reached between Escada AG and Pier with respect to the Payment, let alone that such agreement provided that Pier should receive the Payment without consideration. Plaintiff does state that Pier was not a creditor of Escada AG (Amended Complaint ¶ 12). But being not a creditor does not imply that Escada AG and Pier agreed that the Payment should be without consideration. Furthermore, Plaintiff notes that "[t]he reason for the transfer of Funds has not been established" (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-p. 15.) If no reason is factually asserted by Plaintiff, then the reason "gift" or "gratuity" is likewise not factually asserted. The Amended Complaint states, or can be understood to state, that there was no consideration in exchange for the Payment (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-pp. 13-14). But this does not imply that this lack of consideration was based on an agreement that had been reached between the parties to the Payment, Escada AG and Pier. There are other legal concepts conceivable that might explain this transaction. Plaintiff himself points to the possibility that "the funds were transferred improperly, without any legitimate basis at all" (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-pp. 15). In this case, however, Escada AG might be entitled to restitution under unjust enrichment law, or, if Escada AG had forgone this right, the loss of this right might constitute a "gratuitous" act voidable under § 134 German Insolvency Act.

If American law of civil procedure will arrive at the same interpretation of the Amended Complaint, then the Basic Test for § 134 German Insolvency Act is not met.

b) Special Test for Transfers to Third-Party Creditors

The factual allegations made in the Amended Complaint with respect to Defendant Pier do not call for an application of the Special Test that has been developed for transfers to third-party creditors. There is no indication that the Payment was made to meet a payment obligation that had been incurred to Pier by a third-party debtor.

c) Special Test for Unjust Enrichment Situations

The Special Test for Unjust Enrichment Situations seems to be met. This presupposes, however, that the Amended Complaint can be interpreted to state

that the Payment (by Escada AG to Pier) lacked an adequate legal basis, and

that Escada AG, when initiating the Payment, knew of the absence of a legal basis.

Again, the interpretation of the Amended Complaint is a matter of American law. When I give my own interpretation here, I merely try to make this Report as comprehensive as possible.

The Amended Complaint does not state in express terms that the Payment lacked a legal basis (cf. Amended Complaint ¶ 12), but may be interpreted to this effect. The statement that Pier was not a creditor of Escada AG (Amended Complaint ¶ 12) implies that the Payment was not based on a contract that existed between Escada AG and Pier and that required Escada AG to pay to Pier. Since the contract is the most common type of legal basis, the statement mentioned ("no creditor") comes close to saying that the Payment had no legal basis at all. This interpretation is supported by Plaintiff's memorandum of July 24, 2013, where Plaintiff notes that "it is certainly possible that the funds were transferred . . . without any legitimate basis at all" (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-p. 15).

The Amended Complaint does not suggest that Escada AG, when initiating the Payment, was in error and mistakenly assumed that Pier was one of its creditors. (In this case Escada AG would have been entitled to recover the Payment as an unjustified enrichment of Pier.) It appears to be justified to interpret the Amended Complaint to state that Escada AG was aware that the Payment lacked an adequate legal basis. If, however, Escada AG knew that its Payment

had no legal basis, Escada AG forfeited its claim for restitution under unjust enrichment law. In this situation the Payment will be considered, in German avoidance law, a “gratuitous” transaction, voidable under § 134 German Insolvency Act.[23]

d) Conclusion

If my interpretation of the Amended Complaint is correct, the Amended Complaint states a claim of relief under § 134 German Insolvency Act against Defendant Pier.

e) Additional Comments

(i) Context With the Release of BiBA from the Guarantee

This report does not deal with any link that might exist between the Payment and the release of BiBA from its Guarantee of the EUR 200 million Bond issued by Escada AG. The Amended Complaint does not contain any statement on the Bond and on the conditions under which the guarantee given by a guarantor subsidiary (like BiBA) would end (cf. Amended Complaint ¶¶ 8-9). *If* the Payment was a part of the warp and woof of the sale of BiBA and BiBA’s release from the Guarantee, the issues of avoidance law would need to be reconsidered.

(ii) Limitation of the Avoidance Liability Under § 134 German Insolvency Act

This report does not deal with any limitation that might apply to Pier’s liability under § 134 German Insolvency Act. Pursuant to § 143(2) German Insolvency Act, the avoidance liability based on § 134 German Insolvency Act is limited to the extent that the recipient of the “gratuitous” transaction is still enriched. In the factual scenario under review in this part of the Report (Defendant Pier; not a creditor of Escada AG; § 134 German Insolvency Act), the Amended Complaint does not assert any facts that might give rise to the issue of loss of enrichment; there is no statement on the use of the Funds by Pier (cf. Amended Complaint ¶¶ 8-9).

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23 See text supra preceding footnote 8.

II. Defendant HS Asset
(§ 134 German Insolvency Act)

1. Factual Assertions of the Amended Complaint
(Defendant HS Asset, § 134 German Insolvency Act)

As regards Defendant HS Asset, Plaintiff states the following fact situation, in addition to the "General Facts" (summarized in Part 0 of this Report):

(I) Insolvency Proceedings

-- Part 0 "General Facts"

(II) The Payment

-- Part 0 "General Facts"

(III) Relationship Between Escada AG and Pier

Pier was not a creditor of Escada AG (Amended Complaint ¶ 12).

(IV) Relationship Between Pier and HS Asset

Pier forwarded the Funds to HS Asset on the same day it had received them (July 24, 2009) (Amended Complaint ¶ 15).[24] The Funds were credited to an account maintained by HS Asset also at Compass Bank (Amended Complaint ¶ 15).

Note: The March 7 Letter states that the account of HS Asset was with The Savannah Bank (March 7 Letter, document 23-1, filed July 24, 2013, pdf-p. 3).

The Amended Complaint (¶ 15) does not state the reason for this transfer (from Pier to HS Asset). It is for American law (of civil procedure) to decide whether the Amended

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24 In ¶ 15 of the Amended Complaint the date is "June" 24, 2009. This seems to be a writing error.

Complaint may be interpreted to state that, in this factual scenario, Pier, when receiving the Funds from Escada AG (via Gelco), acted as a fiduciary of HS Asset.

> *Comment*: As regards the avoidance claim against Pier, the Amended Complaint may be interpreted to state that Pier was not a fiduciary or conduit for HS Asset (cf. Plaintiff, Memorandum July 24, 2013, Document 20, pdf-p. 14). But with respect to the avoidance claim against HS Asset, Plaintiff does not repeat this statement (cf. Plaintiff, Memorandum July 24, 2013, Document 20, pdf-p. 16). The avoidance attack can reach HS Asset only if HS Asset was the beneficiary of the Payment.

(V) Relationship HS Asset and Escada AG

HS Asset was not a creditor of Escada AG (Amended Complaint ¶ 18).

(VI) Relationship Between HS Asset and Escada USA

HS Asset was a creditor of Escada USA. HS Asset and Escada USA had entered into an "Owner-Manager Agreement" on or about July 24, 2009. Pursuant to this contract HS Asset was to serve as a construction manager to remodel certain store locations of Escada USA in the U.S. (Amended Complaint ¶ 16).

The Owner-Manager Agreement (Section 3.1) required Escada USA to transmit USD 2.3 million to HS Asset to fund the remodeling projects contemplated in the Agreement. This sum is defined as "Prepaid Purchase Price" and, according to Section 3.4 of the Owner-Manager Agreement, is considered to be a "payment in advance for the anticipated costs and expenses necessary to complete" the projects, defined in the Agreement as "Eligible Expenses". (March 7 Letter, document 23-1, filed July 24, 2013, pdf-p. 3; the Amended Complaint, ¶ 16, refers to the March 7 Letter.)

> *Note to Judge Schofield*: This paragraph is from the March 7 Letter. I do not know whether the complete letter (and not only the parts reproduced in the Amended Complaint) may be considered as factual basis of the Amended Complaint.

The Owner-Manager Agreement requires Escada USA to pay HS Asset a fee of 2.5% of the amounts disbursed by HS Asset to the contractors and other service providers (Amended Complaint ¶ 16).

Escada USA had made an advance payment to HS Asset (on July 20, 2009), as required by Section 3.1 of the Owner-Manager Agreement, into the same bank account (apparently maintained by Pier), to which the Funds paid by Gelco, at Escada AG's direction, to Pier were credited four days later (on July 24, 2009). The sum received from Escada USA was transferred from the Pier account to the bank account of HS Asset (also on July 24, 2009, as were the Funds that stemmed from Escada AG).

(not in the Amended Complaint, but in the March 7 Letter, document 23-1, filed July 24, 2013, pdf-p. 3; not relied on in this Report)

In performance of the Owner-Manager Agreement, HS Asset engaged certain contractors and service providers and acted as a conduit for Escada USA's payments to these contractors (Amended Complaint ¶ 16). The sum paid by Escada AG (EUR 1,621,126.76, "Funds") was thereafter paid by HS Asset to the contractors and service providers (Amended Complaint ¶ 17).

I will argue that it appears permissible to interpret the Amended Complaint to state that the Payment (by Escada AG to Pier) was made in order to satisfy the payment obligation incurred by Escada USA to HS Asset in the Owner-Manager Agreement.

The Amended Complaint does not state that, but rather leaves open whether, HS Asset and the contractors actually performed any services, and, if so, whether the services were of "fair market value" (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-pp. 15 and 16).

2. Legal Opinion
(Defendant HS Asset, § 134 German Insolvency Act)

I will arrive at the conclusion, that Plaintiff's Amended Complaint does not state a claim for relief under § 134 German Insolvency Act.

a) General Requirement: Applicability of § 134 German Insolvency Act to HS Asset

On the basis of the facts stated in the Amended Complaint, HS Asset is the wrong defendant. The avoidance remedy of § 134 German Insolvency Act does not lie against HS Asset, but would lie against Escada USA.

(i) Requirement: "Recipient"

An avoidance action may only be brought against the "recipient". This is the person who benefits from the debtor's (possibly voidable) transaction.[25] Where the transaction is the incurrence of an obligation, the creditor of this obligation would be the proper defendant; where an asset was transferred, the avoidance remedy applies against the transferee.

(ii) Relationship Pier - HS Asset

Since Escada AG made the Payment to Pier (and not to HS Asset), a legal concept is needed which will allow to apply the avoidance remedy of § 134 German Insolvency Act against HS Asset (instead of Pier).

One such concept is legal succession (§ 145(2) German Insolvency Act). In German law, however, the concept of legal succession does not apply to transfers of "money" held in a bank account.[26] The rights the transferee of a bank transfer acquires vis-à-vis its bank are not deemed to be identical to the rights the transferor loses in the contractual relationship with its bank. The concept of legal succession would cover the transfer of bills and coins (provided that those bills

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25 The term "recipient" appears in various statutory provisions of avoidance law, e.g. in §§ 143 and 144 German Insolvency Act. Jurisprudence: Bundesgerichtshof (Federal Court of Justice), Sept. 29, 2011, IX ZR 202/10, ¶ 11. Legal literature: Heidelberger Kommentar zur Insolvenzordnung (Kreft), 6th edition 2011, § 129 ¶ 93; Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Volume 4, 2008, § 143 ¶ 99.

26 Bundesgerichtshof (Federal Court of Justice), June 24, 2003, IX ZR 228/02, ¶ 29. Unanimous opinion among legal writers; e.g. Heidelberger Kommentar zur Insolvenzordnung (Kreft), 6th edition 2011, § 145 ¶ 5.

and coins are being held separately by the transferee and can still be identified); but a cash payment is not at issue here.

Another concept derives from (German) trust law.[27] If the person to whom the (possibly voidable) payment is made is the trustee (fiduciary) of another person, this other person will be the one liable under the avoidance rules.[28] This means: If Pier received the Funds as a fiduciary of HS Asset, the latter would be the beneficiary of the Payment, and the avoidance remedy of § 134 German Insolvency Act would apply against it (i.e. HS Asset). The relationship between Pier and HS Asset is subject to American law. The Amended Complaint does not state any details of this relationship; it does not state why Pier remitted the Funds to HS Asset. Nor does the March 7 Letter (which the Amended Complaint refers to) shed light on this relationship.[29] I will assume that the Amended Complaint may be interpreted, in the factual alternative under review, to state that Pier acted as a fiduciary of HS Asset when it received the Payment by Escada AG. The same assumption is made by the Lüke Report: In order to establish an avoidance claim against HS Asset, Professor Dr. Lüke assumes that Pier acted as trustee of HS Asset and that therefore HS Asset was the true recipient of the Payment.[30] If this assumption were not made, the suit against Defendant HS Asset (insofar as it is based on fraudulent conveyance law, § 134 or § 133 German Insolvency Act) would fail already at this stage. (It will fail at the stage.)

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27 German trust law differs considerably from American trust law. The beneficiary does not retain or acquire a property interest in the assets covered by the trust agreement. A German law trust is (merely) a consensual fiduciary relationship, partly resembling the American law of agency.

28 E.g. Kübler / Prütting / Bork (Brinkmann), Kommentar zur Insolvenzordnung, looseleaf, 2013, § 145 Appendix I ¶ 5, citing two rulings of the Bundesgerichtshof (Federal Court of Justice), which are going to be cited here in footnote 25 infra.

29 The March 7 Letter states that Pier remitted all funds sent to it by or on behalf of Escada USA to HS Asset "as required by a certain construction contract between HS Asset and Escada USA", document 23-1, filed July 24, 2013, pdf-p. 2. Since Pier was not a party to this contract, its payment to HS Asset can hardly be attributed to this contract.

30 Lüke Expert Report, filed July 25, 2013, Document 24, English version, p. 22.

(iii) Relationship HS Asset - Escada USA

The very concept that in the relationship Pier - HS Asset justifies applying the avoidance law remedy against HS Asset (instead of Pier) precludes HS Asset from being liable as a fraudulent transferee, if we take account of the relationship with Escada USA, too.

Under the Owner-Manager Agreement Escada USA was required to pay USD 2.3 million to HS Asset (Section 3.1 of the Agreement, insofar not expressly stated in the Amended Complaint; but the Amended Complaint does state that HS Asset agreed to act as a conduit for Escada USA's payments to the contractors, Amended Complaint ¶ 16). The Payment (made by Escada AG to HS Asset, via Pier) was earmarked to (partly) perform this payment obligation owed by Escada USA (again, not expressly stated in the Amended Complaint, but in the March 7 Letter).[31] However, the sum mentioned (USD 2.3 million) does not represent the remuneration that was due to HS Asset for its services under the Owner-Manager Agreement. Rather, this sum represented an advance on the expenses anticipated for the planned construction and remodeling projects, in particular on the remuneration of the contractors (Amended Complaint ¶¶ 16 and 17; March 7 Letter, document 23-1, filed July 24, 2013, pdf-p. 3). The Owner-Manager Agreement requires HS Asset to use this sum to pay for certain costs which are defined in the Owner-Manager Agreement (as "Eligible Expenses"). HS Asset had agreed "to act as a conduit for Escada USA's payments to the contractors and other service providers" entrusted with the construction works (Amended Complaint ¶ 16).

The relationship between HS Asset and Escada USA, including the duties owed by HS Asset to Escada USA with respect to the advances, is governed by American law. German law has to decide what the implications are for the person(s) against whom the avoidance remedy may apply.

In order to be able to continue with this Report, I will make the following assumption:

> HS Asset was not entitled to use the sums paid to it by Escada AG (and by Escada USA) for its own purposes. Under the Owner-Manager Agreement HS Asset had the

31 Another part (USD 49,982.50) of the sum mentioned was paid by Escada USA to Pier; March 7 Letter, document 23-1, filed July 24, 2013, pdf-p. 3.

duty to use those funds only on Escada USA's behalf. HS Asset held these funds as a fiduciary of Escada USA.

(iv) Person Liable Under Avoidance Law
(where transfer to the fiduciary of a third person)

In the situation just described the rule of German law seems to be that the person liable under avoidance law (as the fraudulent transferee) is (only) the beneficiary and not the fiduciary. This rule is based on the following authorities.

In a case decided by the Bundesgerichtshof (Federal Court of Justice) in 2009, the debtor (i.e. the person who later became the insolvency debtor) made a payment to person A. Previously A had agreed, in a contract with person B, to act as a fiduciary for B in regard to any payments that the debtor would make. The Court held: "[B] was the *immediate recipient* of the payments from the debtor" and thus the proper target of the avoidance attack.[32] By labeling B "the immediate recipient", the Court stated that A was not a "recipient" for the purposes of avoidance law and an avoidance action would not lie against A, although it was A to whom the payment had been made.[33] If one applies this holding to our case, the avoidance action brought by Plaintiff does not lie against HS Asset, the fiduciary, but should be brought or should have been brought against Escada USA, the beneficiary and "true" or, according to the Bundesgerichtshof, even "immediate" recipient of the Payment.

This rule has been corroborated by various legal commentators.

I already mentioned the statement of Brinkmann: If a transfer is made to a person who is the fiduciary of another person, this other person, the beneficiary, is liable under avoidance law, not the fiduciary.[34]

The same statements are made by Kirchhof and Kreft.[35]

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32 Bundesgerichtshof (Federal Court of Justice), March 12, 2009, IX ZR 85/06, ¶ 2 (last sentence, emphasis added). An English translation of this decision is on file with the Court: Declaration Müller, Exhibit C, Document 14-2, filed May 15, 2013, pdf-p. 2. -- This decision was confirmed by Bundesgerichtshof (Federal Court of Justice), Dec. 17, 2009, IX ZR 16/09, ¶ 12.

33 See Zeuner, Urteilsanmerkung, jurisPR-InsR 15/2010 Anm. 1 (sub D).

34 Supra footnote 21.

Henckel treats the case that the future insolvency debtor transfers an asset to a person A, who is the trustee of both the debtor and a person B to whom the asset shall ultimately be transferred. The avoidance law remedy does not apply against A (the trustee), but only against B.[36]

The same position is held by Kayser, treating the same hypothetical.[37] (Judge Kayser has been presiding, since 2010, at the (ninth) chamber of the Bundesgerichtshof, which is the chamber in charge of insolvency law cases.)

Bork voices the same opinion.[38]

Another author, Primozic, writes, referring to Bundesgerichtshof IX ZR 85/06: The avoidance law remedy does not apply to the fiduciary who received the transfer on behalf of a third person. Only the third person (beneficiary) is to be considered the "recipient" for the purposes of avoidance law.[39]

I did not find any Bundesgerichtshof ruling or law review article or commentary to the contrary.

There seems to be only one ruling which might point in the other direction. Under German labor and social insurance law, the monthly contributions that employers and employees are required to pay to the three systems of national social insurance (health care, retirement, and unemployment) are not collected separately by each system. Rather, one system (the national health care insurance system) has the mandate to collect the contributions to all three systems. The Bundesgerichtshof held that the health care insurance system is deemed the "recipient" of all three contributions and thus liable under avoidance law, although it is required by statute to surrender the respective shares to the other two systems (national retirement insurance and national unemployment insurance).[40] The beneficiaries (i.e. the other two systems) are not deemed proper targets of the avoidance law remedies. In legal literature the opinion prevails that

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35 Münchener Kommentar zur Insolvenzordnung (Kirchhof), 3rd edition, Volume 2, 2013, § 143 ¶ 5; Heidelberger Kommentar zur Insolvenzordnung (Kreft), 6th edition 2011, § 129 ¶ 93.

36 Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Volume 4, 2008, § 134 ¶ 17.

37 Münchener Kommentar zur Insolvenzordnung (Kayser), 3rd edition, Volume 2, 2013, § 134 ¶ 13.

38 Kübler / Prütting / Bork (Bork), Kommentar zur Insolvenzordnung, looseleaf, 2013, § 134 ¶ 27.

39 Primozic, Anmerkung zu Bundesgerichtshof Dec. 17, 2009, IX ZR 16/09, in: NZI 2010, 297 (at 298).

40 Bundesgerichtshof (Federal Court of Justice), Febr. 12, 2004, IX ZR 70/03, ¶¶ 11-16.

this holding cannot serve as a precedent in cases outside social insurance law. Some authors think the decision lacks a sound legal basis anyway;[41] others explain it by the peculiarities of public social insurance law, which prohibit equating its specific collection process to the position of a fiduciary in a private law relationship.[42] And, indeed, thus far this ruling had no impact on cases involving private law fiduciaries and beneficiaries, such as the later decided case IX ZR 85/06.

Where the debtor (i.e. the future insolvency debtor) transferred assets to *its* trustee, the Bundesgerichtshof frequently held the trustee liable under fraudulent conveyance law.[43] But these rulings concern transfers from the debtor to *its* trustee, and such transfers are not at issue here.

Both the Declaration Müller (and the March 7 Letter) and the Lüke Report accept the rule, described in detail here, that the avoidance law remedies apply to the beneficiary of the Payment and not to the fiduciary.[44] Both apply the rule to the relationship between Pier and HS Asset. They (correctly) argue that under said rule Pier is shielded from an avoidance attack, as regards this relationship. The Lüke Report (correctly) concludes that as regards the relationship Pier - HS Asset the avoidance action has to be directed against HS Asset. But this is not the end of the legal analysis. We have to move on to the relationship HS Asset - Escada USA. This, too, seems to be a fiduciary relationship, with HS Asset holding the monies received on behalf of Escada USA. If we apply the rule to this relationship, it is Escada USA (the beneficiary) and not HS Asset (the fiduciary) against whom the avoidance remedies apply.

(v) Concluding Remark

One cannot avoid following suit: The Payment was made to Pier. If one wants to reach HS Asset and hold HS Asset liable as the fraudulent transferee, one has to rely on the rule, stated in the Bundesgerichtshof case IX ZR 85/06, that the fiduciary obligation owed by Pier to HS

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41 Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Volume 4, 2008, § 143 ¶ 99.

42 Münchener Kommentar zur Insolvenzordnung (Kirchhof), 3rd edition, Volume 2, 2013, § 143 ¶ 5a.

43 See, e.g., Bundesgerichtshof (Federal Court of Justice), Apr. 26, 2012, IX ZR 74/11, ¶ 12, citing the preceding rulings.

44 Declaration Müller, Document 14, filed May 15, 2013, p. 5; March 7 Letter, Document 23-1, filed July 24, 2013, pdf-p. 4,; Lüke Expert Report, filed July 25, 2013, Document 24, English version, p. 12. Professor Dr. Lüke uses the term “altruistic trust”. This is the type of trust involved here.

Asset makes the latter the "recipient" within the meaning of the avoidance law remedies. But the same applies to the relationship between HS Asset and Escada USA. Because HS Asset could not use the Funds for its own purposes but could use them only on Escada USA's behalf, it is, again, the latter which is the person liable under avoidance law.

b) Specific Requirements of § 134 German Insolvency Act

> *Note to Judge Schofield*: I am considering omitting this part from the final version of my report. Given the findings in Part a, Part b may be superfluous.

Whether or not the Amended Complaint states the specific requirements of § 134 German Insolvency Act depends on its interpretation by the Court. In order to meet the requirements of § 134 German Insolvency Act, the Amended Complaint needs to be interpreted to state that the services owed by HS Asset (and the contractors) to Escada USA and eventually performed were of less value than the Payment. If the Court does not arrive at this interpretation, the Amended Complaint fails to state the specific requirements of § 134 German Insolvency Act, too.

(i) Basic Test of § 134 German Insolvency Act

Under the Basic Test of § 134 German Insolvency Act, Plaintiff must either plead that Escada AG and HS Asset agreed that HS Asset does not owe any consideration to Escada AG in exchange for the Payment, or that Escada AG and HS Asset did agree on a consideration by HS Asset, but that this consideration was of less value than the Payment. This test is failed. The Amended Complaint does not state that there was any agreement between Escada AG and HS Asset with respect to the Payment.

(ii) Special Test for Unjust Enrichment Situations

The Special Test for unjust enrichment situations is not applicable here. In the factual scenario stated by Plaintiff with respect to Defendant HS Asset, the Payment (of Escada AG to HS Asset) did not result in an unjustified enrichment of HS Asset.

It appears permissible to interpret the Amended Complaint to state that the Payment was made in order to meet Escada USA's payment obligation to HS Asset.

The March 7 Letter states that under Section 3.1 of the Owner-Manager Agreement Escada USA was required to pay USD 2.3 million to HS Asset for the funding of the remodeling of Escada USA's retail stores (document 23-1, filed July 24, 2013, pdf-p. 3). As regards the fact situation under review (suit against HS Asset), the Amended Complaint frequently refers to the March 7 Letter (Amended Complaint ¶¶ 15-17). The Funds paid to HS Asset nearly match the sum required as the advance payment by the Owner-Manager Agreement.

The interpretation mentioned seems to comply with ¶¶ 16 and 17 of the Amended Complaint: Since the Funds were disbursed to the contractors (Amended Complaint ¶ 17), it appears sensible to conclude that their Payment to HS Asset constituted the advance payment(s) owed by Escada USA to HS Asset under the Owner-Manager Agreement.

The Lüke Report is also based on this interpretation: "One must assume that by making such payment [Escada AG] sought to settle [the][45] liabilities incurred from this contractual relationship", by which Professor Dr. Lüke refers to the Owner-Manager Agreement between Escada USA and HS Asset (Lüke Expert Report, filed July 25, 2013, Document 24, English version, p. 23).

If the Payment served to perform the payment obligation owed by Escada USA to HS Asset under the Owner-Manager Agreement, the Payment had an adequate legal basis and did not constitute an unjustified enrichment of HS Asset.

(iii) Special Test for Payments to Third-Party Creditors

In the factual scenario presently under review ("Pier not a creditor of Escada AG; Pier fiduciary of HS Asset; HS Asset not a creditor of Escada AG; HS Asset a creditor of Escada USA") the Special Test for payments to third-party creditors (in this part: only "Special Test") might be applicable. This Special Test applies where the payment (whose avoidance is at issue) was made by the future insolvency debtor (payor, here: Escada AG) with the purpose of

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45 In the English version it is "*its* liabilities", thereby referring to the liabilities of *Escada AG*. This seems to be a translation error. In the German version it is "*the* liabilities" ("auf bestehende Verbindlichkeiten"), meaning the obligations incurred by *Escada USA* in the Owner-Manager Agreement (Lüke Expert Report, filed July 25, 2013, Document 24, German version, pdf-p. 56).

performing an obligation a third person (third-party debtor, here: Escada USA) had incurred vis-à-vis the payee (third-party creditor, here: HS Asset).

> *Caveat*: I did not find any court ruling that applied the Special Test (payment of third-party debt) to a debt resulting from a principal-agent-relationship and involving the payment of such advances to the agent (third-party creditor) as are necessary for the execution of the matters entrusted to the agent. The explanation appears to be the findings of Part a above: If another person (in our case: the future insolvency debtor) pays these advances, the "recipient" of this payment is the principal and not the agent. Nonetheless, I will apply the Special Test here.

Under the Special Test the payee may be subject to an avoidance action by the payor's insolvency receiver, based on § 134 German Insolvency Act, although there is no contractual relationship or other type of agreement between the payor and the payee with respect to the payment, which is essential under the Basic Test.

As opposed to the Basic Test, the Special Test does not focus on the consideration that was due, or was not due, in exchange for the payment. Rather, the focus is on the "true value" the third-party creditor's right to payment, founded in the contract with the third-party debtor, had at the time when the payment was made (by the future insolvency debtor). If this value was depressed, due to the lack of solvency of the third-party debtor, the payment will be considered "gratuitous".

In many cases, the insolvency of the third-party debtor will support the conclusion that the right to payment which the payee had against the third-party debtor lacked true value and that the payment to the payee is thus deemed to be "gratuitous". In one of its holdings on payments of debts owed to the payee by a third-party debtor, the Bundesgerichtshof (Federal Court of Justice) stated as a principle:

"A payment by the future insolvency debtor to a third-party creditor will be deemed 'gratuitous' if the third-party debtor was insolvent at the time of the payment."[46]

I think it is legitimate to assume that Escada USA (third-party debtor) was insolvent at the time of the Payment.[47] The Amended Complaint does not make any statement on the financial situation of Escada USA. It is highly likely, however, that Escada USA was insolvent. At the time of the Payment, Escada AG, the German mother, was insolvent. On July 24, 2009, it could be foreseen that the holders of the EUR 200 million bond, issued by Escada AG, would not accept, by the approval deadline of July 31, 2009, a 50% cut of their payment rights, as proposed by Escada AG. The rejection of this proposal triggered the insolvency petition of Escada AG (on Aug. 13, 2009). Due to the insolvency of Escada AG, Escada USA became liable for the repayment of the Bond, for which it had guaranteed. Apparently, Escada USA was not in a financial position to honor this guarantee: On Aug. 14, 2009, which is one day after the German petition and three weeks after the Payment, Escada USA petitioned for bankruptcy relief under chapter 11 of the U.S. Bankruptcy Code.

There are various exceptions to the rule that the insolvency of the third-party debtor indicates that the payment obligation owed by it to the third-party creditor was of depressed value. One of these exceptions seems to be applicable here. The third-party creditor's payment claim is not of depressed value, despite the insolvency of the third-party debtor, where the third-party creditor still owed *its* performance of the contract at the time when the payment was made and performed at a later date.[48]

(This next paragraph may be skipped. It will offer an explanation for this exception.) The idea behind this exception seems to be that in this case the third-party creditor's right to payment was secured at the time of the payment: The security was the

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46 Bundesgerichtshof (Federal Court of Justice), Oct. 22, 2009, IX ZR 182/08, guiding principle no. 1, translation by me. See also Münchener Kommentar zur Insolvenzordnung (Kayser), 3rd edition, Volume 2, 2013, § 134 ¶ 31b.

47 Professor Dr. Lüke likewise argues that Escada USA was insolvent on July 24, 2009. See Lüke Expert Report, filed July 25, 2013, Document 24, English version, p. 24.

48 Bundesgerichtshof (Federal Court of Justice), June 5, 2008, IX ZR 163/07, ¶¶ 15 to 17. An English translation of this decision is on file with the Court: Declaration Müller, Exhibit C, Document 14-3, filed May 15, 2013, pdf-pp. 2-3.

third-party debtor's contractual right that the third-party creditor perform its obligation under the contract. This contractual right (of the third-party debtor) served as a security for the third-party creditor's contractual right to payment. In other words: As long as the third-party creditor has not yet performed (its obligation under the contract), it enjoys a distributional privilege. Let us assume the third-party debtor enters insolvency proceedings. The value its contractual claim (against the third-party creditor) has will inure to the benefit of the third-party creditor's contractual right to payment. This holds true no matter whether the contract will be assumed or rejected in the insolvency proceeding (of the third-party debtor).[49] The third-party creditor's obligation, still unperformed at the time of the payment, thus serves as a security for the third-party creditor's payment claim. And vice versa: Had the third-party creditor already performed its contractual obligation at the time of the payment, the exception does not apply:[50] In that case the third-party creditor's contractual right to payment was of depressed value, because the third-party debtor's right to performance had already been satisfied and could no longer have the effect of securing the third-party creditor's right to payment.

In the case at hand, the exception seems to apply. The insolvency of Escada USA (as third-party debtor) does not imply that HS Asset's contractual right to payment (arising from the Owner-Manager Agreement) lacked value (at the time of its satisfaction by Escada AG). By entering the Owner-Manager Agreement with Escada USA, HS Asset had incurred various obligations with respect to the planned remodeling of certain store locations in the US, such as acting as "construction manager" (Amended Complaint ¶ 16). At the time of the Payment (July 24, 2009) HS Asset had not yet performed these obligations. The March 7 Letter, to which the Amended Complaint refers, states that "thereupon", which means after July 24, 2009, HS Asset began performing its obligations under the Owner-Manager Agreement (Amended Complaint ¶ 16). In this situation (i.e. performance of the contractual obligations of the third-party creditor

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49 von Wilmowsky, Insolvenzvertragsrecht: Die Grundstruktur, KTS (Zeitschrift für Insolvenzrecht) 2011, 453 (at 462-464).

50 Bundesgerichtshof (Federal Court of Justice), March 3, 2005, IX ZR 441/00, ¶¶ 15 and 17; Landgericht (District Court) Magdeburg, Dec. 9, 2010, 5 O 751/10 (155), ¶ 23.

still outstanding) the third-party creditor's right to payment is not deemed to be economically depressed by the third-party debtor's insolvency. In addition German jurisprudence requires that the third-party creditor did indeed perform its contractual obligations (which were outstanding at the time of the payment) after the payment, a condition that apparently is also met.[51]

The exception just applied is also referred to in the Lüke Report. Professor Dr. Lüke holds that this exception speaks against considering the Payment to be "gratuitous".[52]

These arguments point to the conclusion that the Special Test for § 134 German Insolvency Act is failed, too, and that thus the Payment cannot be considered "gratuitous" as against HS Asset.

There seems to be only one escape route from this conclusion. If the services of HS Asset and the contractors envisaged in the Owner-Manager Agreement had less value than the Payment, or if the services eventually performed by HS Asset and the contractors, were of less value than the Payment, the Payment will be deemed "gratuitous" and thus, to this degree, covered by § 134 German Insolvency Act. But is this factual scenario stated in the Amended Complaint? The Amended Complaint refers to the March 7 Letter pursuant to which the Funds were disbursed to the contractors (Amended Complaint ¶ 17). But it does not state that the contractors did not perform any services or that the services performed did not have the value of the Payment. In a subsequent memorandum, Plaintiff notes that "it is not established that HS Asset (or the subcontractors for whom it supposedly received the Funds) actually performed any services, let alone that the services were of fair market value" (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-p. 15). Even if one would supplement the Amended Complaint with this statement, the pleading does not appear to be sufficient. Plaintiff merely states that the value of the services owed and performed by HS Asset and the contractors is not known. What is needed, however, is the assertion that these services either did not exist or were of less value than the Payment. – But interpreting the Amended Complaint is governed by the rules of American civil procedure, with which I am not familiar.

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51 Supra footnote 41.

52 Lüke Expert Report, filed July 25, 2013, Document 24, English version, p. 25. -- Professor Dr. Lüke then continues by emphasizing that Escada USA was the beneficiary of the Payment (p. 25). But I fail to understand how this aspect might reverse the conclusion forced by the exception and lead the Court to "possibly see sufficient grounds for an avoidance claim on the basis of sect. 134 InsO" (p. 26).

Question 3: § 133 German Insolvency Act

What are the elements of a claim under Section 133 of the German Insolvency Law? Do the facts as alleged in Plaintiff's [Amended] Complaint support a claim for relief under Section 133 of the German Insolvency Law in the event that the Court allowed Plaintiff to amend its Complaint?

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A. § 133 German Insolvency Act: Requirements

§ 133 German Insolvency Act defines another threshold at which an act of the debtor that is detrimental to the debtor's creditors becomes voidable: the debtor's *intent* to cause harm to its unsecured creditors.[53] Four requirements must be met.

I. Act by the Debtor Detrimental to the Debtor's Creditors

§ 134 German Insolvency Act belongs to the debtor misconduct branch of avoidance law (in the US: fraudulent conveyance law) and thus requires a transaction made by the debtor that is detrimental to the debtor's (unsecured) creditors. "Detriment" covers any hindrance of their efforts to collect from the debtor and thus any impairment of the satisfaction of their claims. The transaction can be the incurrence of an obligation or the transfer of an asset, without receiving a reasonably equivalent value in exchange for such obligation or transfer. But other forms of impairment such as hindrance and delay are covered as well. The term "detriment" thus roughly equates to the modes of creditor injury described in § 548(a)(1)(A) and (B)(i) B.C. (and in §§ 4(a) and 5(a) UFTA).

II. The Debtor's Intent to Inflict Detriment on Its Unsecured Creditors

In itself, the detrimental effect on the debtor's creditors is no ground of avoidance: The creditors expect their debtor to take entrepreneurial risks, without which the debtor would not be able to generate the revenues necessary to pay the interest rates negotiated with them, and they know that such risks may lead to losses. In order to come within the ambit of the avoidance rules, an additional element is needed, one that reflects that the transaction was a grave misconduct by the debtor against its creditors and that supports the presumption that most creditors would forbid this behavior if they could.[54] In the case of § 133 German Insolvency Act

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53 This ground of avoidance roughly parallels Section 548(a)(1)(A) B.C. (§ 4(a)(1) UFTA). As opposed to its American counterpart, § 133 German Insolvency Act not only requires the harmful intent on the part of the debtor, but also the defendant's knowledge of the debtor's harmful intent.

54 This is the rationale of the debtor misconduct branch of avoidance law. See Thole, Gläubigerschutz durch Insolvenzrecht, 2010, pp. 298-299. With respect to U.S. fraudulent conveyance law: Baird, The Elements of Bankruptcy, 5th edition 2010, chapter 7.

this additional element is the debtor's intent: The debtor engaged in the detrimental transaction with the intention to cause harm to its unsecured creditors.

In German legal doctrine intent is made up by two components:[55]

Knowledge: The debtor was aware that its act would have detrimental effects on its unsecured creditors.

Approval: The debtor approved of these detrimental effects.

Since it is difficult to prove the subjective intention of the debtor, the courts may rely on circumstantial evidence to establish the debtor's harmful intention. One of these circumstantial factors is the insolvency, or imminent insolvency, of the debtor: If the debtor was insolvent, or if insolvency was imminent, at the time of the transaction, and the debtor was aware of its financial situation, and the transaction diminished the debtor's own property, the courts may conclude, firstly, that the debtor knew that its conduct will impair the position of its unsecured creditors, and, secondly, that the debtor approved of this impairment.[56]

American law uses the term "fraudulent intent".[57] This term will be used here as well (in addition to "harmful intent"). This does not imply, however, that such intent requires that the debtor deceive its creditors or act maliciously (as the ordinary sense of "fraudulent" suggests).

III. The Defendant's Knowledge of the Debtor's Intent

A third element is required in order to set aside a transaction under § 133 German Insolvency Act: the defendant's knowledge of the debtor's fraudulent intent. This is a high hurdle indeed. But again, there is a rule, this time in the statutory provision itself, which facilitates the proof of such knowledge. Pursuant to the second sentence of § 133(1) German Insolvency Act, the knowledge of the defendant (of the debtor's fraudulent intent) will be presumed if the defendant knew of the debtor's imminent insolvency and of the harm the transaction would inflict on the unsecured creditors.

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55 Consensus view; e.g., Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Volume 4, 2008, § 133 ¶¶ 22-23.

56 Consensus view; e.g., Heidelberger Kommentar zur Insolvenzordnung (Kreft), 6th edition 2011, § 133 ¶ 10.

57 Tabb, The Law of Bankruptcy, 2nd edition 2009, § 6.29.

IV. Reach-Back Period

§ 133 German Insolvency Act reaches transactions the debtor made within ten years before the insolvency petition.

V. English Translation

The English translation of § 133(1) German Insolvency Act published on the Web site of the (German) Federal Ministry of Justice reads:

> "Section 133 -- Wilful Disadvantage
>
> (1) A transaction made by the debtor during the last ten years prior to the request to open insolvency proceedings, or subsequent to such request, with the intention to disadvantage his creditors may be contested if the other party was aware of the debtor's intention on the date of such transaction. Such awareness shall be presumed if the other party knew of the debtor's imminent illiquidity, and that the transaction constituted a disadvantage for the creditors."

B. Amended Complaint: Statement of a Claim for Relief Under Section 133 of the German Insolvency Act?

Does Plaintiff's Amended Complaint state a claim for relief under Section 133 of the German Insolvency Law?

The Amended Complaint is directed against two defendants and states alternative fact situations, depending on the defendant. Each defendant, with the corresponding fact situation, will be considered in turn.

My Report will arrive at the conclusion that, in the applicable factual scenario pleaded by Plaintiff, neither Defendant Pier nor Defendant HS Asset appears to be liable under § 133 German Insolvency Act.

I. Defendant Pier

1. Factual Assertions of the Amended Complaint (Defendant Pier)

The Amended Complaint does not seem to plead § 133 German Insolvency Act as a ground of avoidance (cf. Amended Complaint ¶ 12, pleading § 131 and § 134 German Insolvency Act as (alternative) grounds of avoidance).

I will assume that in regard to § 133 German Insolvency Act Plaintiff states a fact situation analogous to the one he states with respect to § 134 German Insolvency Act. § 133 German Insolvency Act belongs to the same branch of avoidance law as does § 134 German Insolvency Act, i.e. the voidableness due to debtor misconduct against the creditors (U.S. law: law of fraudulent conveyances). This branch does not require the defendant to be a creditor of the debtor.

The factual assertions will be the same as in Report on Question 2 (§ 134 German Insolvency Act, Defendant Pier);[58] only the statements (or rather assumed statements) on the subjective elements will be added.

(I) Insolvency Proceedings

Part 0 "General Facts"

(II) The Payment

Part 0 "General Facts"

(III) Relationship Between Escada AG and Pier

Pier was not a creditor of Escada AG (Amended Complaint ¶ 12).

No consideration was given or promised by Pier to Escada AG in exchange for the Payment (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-pp. 13-14).[59]

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58 Report on Question 2, part B I 1.

The Amended Complaint does not make any further statements on the relationship between Escada AG and Pier. Neither does it expressly state that the parties had reached an agreement regarding the Payment, nor does it expressly exclude such an agreement. How the Amended Complaint is to be interpreted, is for American law to decide (and therefore beyond the scope of this Report). However, in order to implement the tests relevant for § 133 German Insolvency Act, the relationship between Escada AG and Pier is of critical importance. I therefore cannot avoid interpreting the Amended Complaint.

My interpretations (as regards Defendant Pier and § 133 German Insolvency Act) will be:

> The Amended Complaint may not be interpreted to state that there was an agreement between Escada AG and Pier to the effect that Pier should receive the Payment without giving a consideration in return.
>
> The Amended Complaint may be interpreted to state that the Payment (by Escada AG to Pier) lacked an adequate legal basis, and that Escada AG was aware of this absence of a legal basis. This assumption is favorable for Plaintiff, but may be justified in the present stage of the litigation.

(IV) Role of HS Asset

The Amended Complaint seems to state that Defendant Pier, and not Defendant HS Asset, was the beneficiary of the Payment and, in particular, did not act as a conduit for HS Asset (Plaintiff, Memorandum July 24, 2013, Document 20, pdf-pp. 14 and 15).

(V) Subjective Elements

The Amended Complaint does not make any statements concerning the knowledge and the intentions Escada AG had at the time, and in respect, of the Payment. Again with the caveat that interpreting the Amended Complaint is a matter of American civil procedure (and not of German insolvency law), I will make the following assumptions:

The Amended Complaint may be interpreted to state that

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59 This is not expressly stated in the Amended Complaint, but may be gained by interpreting the Amended Complaint.

the Payment was not based on a contract between Escada AG and Pier, and that Escada AG was aware of this lack of a legal basis;

Escada AG, at the time of the Payment, was aware of its imminent or already existing insolvency.

As regards Pier, the Amended Complaint seems to state that Pier knew of the present or imminent insolvency of Escada AG. But the Amended Complaint, in my tentative judgment, cannot be interpreted to state that Pier knew that Escada AG was aware that its Payment had no legal basis.

2. Legal Opinion
(Defendant Pier, § 133 German Insolvency Act)

Should my interpretation of the Amended Complaint prove correct, the Amended Complaint does not support a claim of relief under § 133 German Insolvency Act against Defendant Pier.

a) Act by Escada AG Detrimental to Escada AG's Creditors

(i) Act by the Debtor

The act whose voidableness is being considered must be attributable to the future insolvency debtor.[60] In the present case, it is true that the payment (to Pier) was made by Gelco, and not by Escada AG (the entity that later became insolvent). But the payment may be legally attributed to Escada AG: Escada AG instructed Gelco to make the Payment (Amended Complaint ¶¶ 9 and 10).

Gelco was a debtor of Escada AG; it owed Escada AG the purchase price for BiBA (Amended Complaint ¶ 8). If the entity that later becomes insolvent instructs one of *its* debtors to pay not to it but to another person, the resulting payment to such other person is, under

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60 The term "act" is used here to indicate that not only legal transactions (such as transfers of assets and incurrences of obligations), but also factual acts (such as the processing of goods) can be the target of an avoidance attack. Professor Dr. Lüke uses the term "transaction"; Lüke Expert Report, filed July 25, 2013, Document 24, English version, p. 7. But the understanding appears to be the same.

German law and for the purposes of avoidance law, considered to be a payment by the future insolvency debtor. The payment by the future insolvency debtor's debtor is treated as if it had been made by the insolvency debtor. This view is widely held by both courts and legal writers.[61]

In a case decided by the Bundesgerichtshof (Federal Court of Justice) in 1999, the entity which later became insolvent (A) had sold equipment to B. After the contract was signed, A instructed B (the debtor of the purchase price) to pay the purchase price to C. B did as instructed, and C understood that the payment had been caused by A's instruction of B. The Court held that the issue whether the payment (by *B* to C) was voidable (under the law of avoidance) had to be resolved by an analysis of the relationship between *A* and C; A is to be considered the person who made the payment (payor); and C (the payee) is the person at whom an avoidance action must be directed -- if there was a ground of avoidance.[62]

This view appears to be well founded. The branch of avoidance law under review in this chapter fights misconduct of the future insolvency debtor vis-à-vis its creditors. In the fact pattern here, it is the future insolvency debtor, and not its debtor, who, also from the perspective of the payee, authorizes and controls the payment. If there was misconduct, it would have been committed by the future insolvency debtor, and not by its debtor.

(ii) Detrimental to the Unsecured Creditors

The Payment was detrimental to Escada AG's creditors, if Escada AG received nothing, or too little, in return. According to the assertions made in the Amended Complaint, this requirement is met:

Firstly, Escada AG did not receive a contractual claim against Pier. There was no contractual relationship between Escada AG and Pier; Pier did not incur any obligation to Escada AG in exchange for the Payment.

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61 See, e.g., Kübler / Prütting / Bork (Bork), Kommentar zur Insolvenzordnung, looseleaf, 2013, § 129 ¶ 58; Münchener Kommentar zur Insolvenzordnung (Kayser), 3rd edition, Volume 2, 2013, § 129 ¶ 35; Heidelberger Kommentar zur Insolvenzordnung (Kreft), 6th edition 2011, § 129 ¶ 28; Thole, Gläubigerschutz durch Insolvenzrecht, 2010, p. 461; all authors citing the relevant case law.

62 Bundesgerichtshof (Federal Court of Justice), Sept. 16, 1999, IX ZR 204/98, ¶¶ 14, 18 and 21. Previously, the Reichsgericht (Supreme Court), in a very similar case, had reached the same conclusion, see Reichsgericht, Febr. 3, 1899, Rev. II 369/98, RGZ 43, 83 (at 84-85).

Secondly, Escada AG did not acquire a right against Pier to recover the Payment as unjust enrichment. It is true, that the Payment was made without an adequate legal basis and thus caused an unjust enrichment of Pier. However, Escada AG forwent its right to restitution, because, when making the Payment, Escada AG knew that it had no obligation to pay the Funds to Pier (§ 814 German Civil Code).[63]

b) Escada AG's Intent to Inflict Detriment on Its Unsecured Creditors

For a transaction to be voidable under § 133 German Insolvency Act, it is essential that the debtor caused the detriment to its creditors not by accident but intentionally. The debtor's intent has to refer not to the transaction, but to the detriment inflicted by the transaction on the debtor's creditors. The Amended Complaint pleads (or can be interpreted to plead) sufficient circumstances to permit the conclusion that Escada AG had the intention to harm its unsecured creditors.

Escada AG knew that it had no contract with Pier that would have obliged it to pay the sum in question to Pier. Escada AG knew that its payment lacked a legal basis. Because of this knowledge, Escada AG deprived itself of its rights on account of Pier's unjust enrichment. This implies that Escada AG was aware that its Payment would not be offset by a right to recovery of the amount paid and that thereby its property would suffer an overall loss because of the Payment.

Since Escada AG was aware of its insolvency or its imminent insolvency, it is justified to presume that Escada AG knew that the overall loss of property would hurt its unsecured creditors. Thus, the knowledge component of the intent to harm the creditors has been established.

The presumption just mentioned extends to the approval component, too: The knowledge of Escada AG of its insolvency and the knowledge of the loss to its property indicate, in the absence of proof to the contrary, that Escada AG approved of the resulting loss to its unsecured creditors.

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63 See Report on Question 2, parts A I 2 and B I 2 c.

c) *Pier's Knowledge of the Escada AG's Harmful Intent*

Plaintiff has to state, and to prove, that Pier knew of Escada AG's intention to harm its unsecured creditors. Plaintiff is aided by the statutory presumption of § 133(1), second sentence, German Insolvency Act: It suffices that Plaintiff states, and proves, that Pier was aware (i) of Escada AG's imminent insolvency and (ii) of the harm that the Payment inflicted on the creditor body of Escada AG.

As to the first element, it appears to be permissible to interpret the Amended Complaint to state that Pier had knowledge of the imminent or present insolvency of Escada AG.[64]

The second element (knowledge of the harm inflicted on the creditors) requires a closer analysis. Within the factual scenario presently under review (Pier no creditor of Escada AG; Pier the beneficiary of the Payment), the Amended Complaint must state that Pier (a) knew that the Payment lacked a legal basis and (b) knew that Escada AG knew of this lack of legal basis. While (a) might yet be a defensible interpretation, (b) is not. I fail to see any circumstances stated in the Amended Complaint which would permit the conclusion: Pier knew that Escada AG made the Payment *knowing* that there was no legal basis for the Payment.

The Lüke Expert Report arrives at the judgment that the knowledge of Pier (of Escada AG's harmful intent) may be concluded from the circumstances of the case.[65] Professor Dr. Lüke argues that, given that Pier knew of Escada AG's imminent insolvency, Pier also knew that any payment to it (i.e. Pier) would inevitably harm "the *other* creditors".[66] But the case Professor Dr. Lüke refers to -- satisfaction of one creditor, thereby automatically causing harm to the other creditors – is not at issue here. In the fact situation under review, Pier is not a creditor of Escada AG; the Payment was not made in performance of an obligation by Escada AG to Pier. If a payment is made to a non-creditor, the payor, in principle, has the right to recover in restitution under unjust enrichment law; the economic loss caused by the payment is offset by the right to recover in restitution. In consequence, the payment to a non-creditor does not diminish the overall property of the payor and thus does not disadvantage the payor's

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64 Also Lüke Expert Report, filed July 25, 2013, Document 24, English version, p. 22: "imminent insolvency of [Escada AG] could be deduced by Defendant [Pier]".

65 Lüke Expert Report, filed July 25, 2013, Document 24, English version p. 22, German version pdf-p. 55.

66 German: "die *weiteren* Gläubiger" (emphasis added); not in the English version; there it is only "creditors".

creditor body. This is different only when the payor knew that it had no obligation to pay; in this case, the payor forfeited its claim to recover the amount paid under unjust enrichment law. In order to establish Pier's knowledge of Escada AG's harmful intent, it is therefore necessary to plead that Pier knew of the harm the Payment to it (Pier) would inflict on the creditor body of Escada AG. It needs to be asserted that Pier knew that Escada AG, when making the Payment, was aware that it did not owe this Payment to Pier.[67]

d) Conclusion

In order to plead an avoidance liability under § 133(1) German Insolvency Act, Plaintiff has to state that Pier knew of the harm the Payment inflicted on Escada AG's creditors (§ 133(1), second requirement in the second sentence, German Insolvency Act). Given that Pier was a non-creditor (meaning that Escada AG did not owe the Payment to Pier), Plaintiff has to state circumstances which would allow the conclusion that Pier realized that Escada AG knew that it had no obligation to make the Payment (and thereby forfeited its right to recover the Payment as an unjust enrichment). I do not think that the Amended Complaint clears this hurdle. But, again, interpreting the Amended Complaint is a matter of American civil procedure.

II. Defendant HS Asset

1. Factual Assertions of the Amended Complaint (Defendant HS Asset)

The Amended Complaint does not seem to plead § 133 German Insolvency Act as a ground of avoidance (cf. Amended Complaint ¶ 18, pleading § 131 and § 134 German Insolvency Act as (alternative) grounds of avoidance).

I will assume that in regard to § 133 German Insolvency Act Plaintiff states a fact situation analogous to the one he states with respect to § 134 German Insolvency Act. § 133 German Insolvency Act belongs to the same branch of avoidance law as does § 134 German

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67 The Lüke Expert Report's line of reasoning would fit, if Pier had been a creditor of Escada AG. This is the factual scenario the Amended Complaint stated for its claim of relief under § 131 German Insolvency Act (Report on Question 1, "additional comment" in part B I 3).

Insolvency Act, i.e. the voidableness due to debtor misconduct against the creditors (US law: law of fraudulent conveyances). This branch does not require the defendant to be a creditor of the debtor.

The factual assertions will be the same as in Report on Question 2 (§ 134 German Insolvency Act, Defendant HS Asset);[68] only the statements (or rather assumed statements) on the subjective elements will be added.

(I) Insolvency Proceedings

Part 0 "General Facts"

(II) The Payment

Part 0 "General Facts"

(III) Relationship Between Escada AG and Pier

Pier was not a creditor of Escada AG (Amended Complaint ¶ 12).

(IV) Relationship Between Pier and HS Asset

Pier forwarded the Funds to HS Asset on the same day it had received them (July 24, 2009) (Amended Complaint ¶ 15). The Funds were credited to an account maintained by HS Asset (Amended Complaint ¶ 15).

The Amended Complaint (¶ 15) does not state the reason for this transfer (from Pier to HS Asset). It is for American law (of civil procedure) to decide whether the Amended Complaint may be interpreted to state that, in this factual scenario, Pier, when receiving the Funds from Escada AG (via Gelco), acted as a fiduciary of HS Asset.

(V) Relationship HS Asset and Escada AG

HS Asset was not a creditor of Escada AG (Amended Complaint ¶ 18).

68 Report on Question 2, part B II 1.

(VI) Relationship Between HS Asset and Escada USA

HS Asset was a creditor of Escada USA. HS Asset and Escada USA had entered into an "Owner-Manager Agreement" on or about July 24, 2009. Pursuant to this contract HS Asset was to serve as a construction manager to remodel certain store locations of Escada USA in the U.S. (Amended Complaint ¶ 16).

The Owner-Manager Agreement (Section 3.1) required Escada USA to transmit USD 2.3 million to HS Asset to fund the remodeling projects contemplated in the Agreement. This sum is defined as "Prepaid Purchase Price" and, according to Section 3.4 of the Owner-Manager Agreement, is considered to be a "payment in advance for the anticipated costs and expenses necessary to complete" the projects, defined in the Agreement as "Eligible Expenses". (March 7 Letter, document 23-1, filed July 24, 2013, pdf-p. 3; the Amended Complaint refers to the March 7 Letter; Amended Complaint ¶ 16.)

Note to Judge Schofield: This paragraph is from the March 7 Letter. I do not know whether the complete letter (i.e. not only the parts reproduced in the Amended Complaint) may be considered as factual basis of the Amended Complaint.

The Owner-Manager Agreement requires Escada USA to pay HS Asset a fee of 2.5% of the amounts disbursed by HS Asset to the contractors and other service providers (Amended Complaint ¶ 16).

In performance of the Owner-Manager Agreement, HS Asset engaged certain contractors and service providers, and agreed to act as a conduit for Escada USA's payments to these contractors (Amended Complaint ¶ 16). The sum paid by Escada AG (EUR 1,621,126.76, "Funds") was thereafter paid by HS Asset to the contractors and service providers (Amended Complaint ¶ 17).

I will argue that it appears permissible to interpret the Amended Complaint to state that the Payment (by Escada AG to Pier) was made in order to perform the payment obligation incurred by Escada USA to HS Asset in the Owner-Manager Agreement.

(VII) Subjective Elements

The Amended Complaint does not make any statements concerning the knowledge and the intentions Escada AG had at the time, and in respect, of the Payment. Again with the caveat that interpreting the Amended Complaint is a matter of American civil procedure (and not of German insolvency law), I will make the following assumptions:

The Amended Complaint may be interpreted to state that Escada AG, at the time of the Payment, was aware of its imminent or already existing insolvency.

As regards HS Asset, the Amended Complaint may be interpreted to state that HS Asset knew of the present or imminent insolvency of Escada AG and of the present or imminent insolvency of Escada USA.

2. Legal Opinion
(Defendant HS Asset, § 133 German Insolvency Act)

I will arrive at the conclusion, that Plaintiff's Amended Complaint does not state a claim for relief under § 133 German Insolvency Act. While the subjective elements which shape this ground of avoidance appear to be pleaded, HS Asset does not seem to be the person liable.

a) General Requirement: Applicability of § 133 German Insolvency Act to HS Asset

In the fact situation stated, HS Asset is the wrong defendant. The reasons have already been developed (Report on Question 2, part B II 2 a).

HS Asset held the monies received from Escada AG (via Gelco and Pier) on behalf of Escada USA. They were advances to fund the costs of the contractors who were to be entrusted with remodeling the retail stores in the U.S. If a payment is made to a person who acts as the fiduciary of another person, this other person is the one liable as the fraudulent transferee.

b) Specific Requirements of § 133 German Insolvency Act

> *Note to Judge Schofield*: I am considering omitting this part from the final version of my report. Given the findings in Part a, Part b may be superfluous.

The specific requirements of § 133 German Insolvency Act appear to be met. The Amended Complaint states an act that is detrimental to Escada AG's creditors (i). The Amended Complaint states circumstances that permit the conclusions that Escada AG acted with the intent to harm its creditors (ii) and that HS Asset was aware of this intention (iii). If an avoidance action will be brought or had been brought against Escada USA, HS Asset's knowledge of Escada AG's harmful intent would be or would have been attributable to Escada USA.

(i) Act by Escada AG Detrimental to Escada AG's Creditors

If somebody pays a third-party debt, he or she will usually be entitled to reimbursement by the third-party debtor. This right to reimbursement will often prevent the payment from being detrimental to the payor's creditors (because it offsets the loss caused by the payment).

The right to reimbursement may flow from a loan agreement, or other type of contract, that the payor had entered into with the third-party debtor, or may be based on a quasi-contractual theory such as negotiorum gestio. It appears therefore justified to assume that by making the Payment to HS Asset Escada AG was entitled to reimbursement by Escada USA. This assumption is buttressed by the claims which Escada AG filed in the chapter 11 proceeding against Escada USA and which seem to include the sum paid by Escada AG to HS Asset ("Gerloff Proof of Claim", referred to by the Declaration Müller, May 5, 2013, Document 14, ¶ 5).

Note to Judge Schofield: That Escada AG filed this claim in the Escada USA bankruptcy proceeding is not stated in the Amended Complaint, but might be "judicially noticeable".

However, Escada AG's right to reimbursement does not balance, at least not fully, the loss caused to Escada AG's property by the Payment. The right to reimbursement is of reduced value. Due to the insolvency of Escada USA, a full reimbursement appears to be highly unlikely. The detriment inflicted by the Payment on Escada AG's unsecured creditors thus lies in the reduced value of Escada AG's right to reimbursement.

(ii) Escada AG's Intent to Inflict Detriment on Its Unsecured Creditors

Both components of the "fraudulent intent" required by § 133 German Insolvency Act have been stated in the Amended Complaint.

Knowledge: Escada AG knew that Escada USA would not be in a position to reimburse Escada AG for the Payment. At the time of the Payment, Escada AG knew that Escada USA was insolvent or on the brink of insolvency. Escada AG knew that Escada USA had guaranteed for its EUR 250 million Bond, and that therefore its own insolvency would cause the insolvency of Escada USA.

Approval: The (German) courts may rely on the facts just mentioned (which establish the knowledge of the injury to the creditors) to conclude that Escada AG approved of the impairment of the position of its unsecured creditors. The relevant circumstantial factors are: the debtor was insolvent, was aware of this financial state, and knew that the transaction in question was detrimental to its own property. Here, these requirements are met.

(iii) HS Asset's Knowledge of the Escada AG's Harmful Intent

Plaintiff will benefit from the statutory rule of presumption in § 133 (1), second sentence, German Insolvency Act. HS Asset knew, or was likely to know, not only of Escada AG's imminent insolvency (which implies that any transaction which deteriorates Escada AG's property injures its creditors). It is also likely that HS Asset knew that the Payment diminished Escada AG's property, because HS Asset likely knew of the (imminent) insolvency of Escada USA, and thus knew that the entitlement to reimbursement by Escada USA was not worth much. Given the knowledge of these circumstances, it is presumed that HS Asset had knowledge of Escada AG's intent to inflict detriment on the unsecured creditors.

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Question 4

Statute of Limitations: Length

How long are the applicable statutes of limitations to claims made under Sections 131, 134, and 133 of the German Insolvency Law?

Report on Question 4

I. The Applicable Statute of Limitations

The rights arising from the voidableness of a transaction (under all grounds of avoidance, including §§ 131, 134, and 133 German Insolvency Act) are subject to a statute of limitations.[69] The German Insolvency Act stipulates that the "standard limitation period" of the Civil Code shall apply (§ 146(1) German Insolvency Act).

The Civil Code's standard limitation period is three years (§ 195 German Civil Code).

Once the limitation period has run, the insolvency receiver may still file a lawsuit. But the defendant is entitled to refuse the performance of any obligation triggered by the voidableness (§ 214(1) German Civil Code). For example, the defendant may refuse the restitution of the asset transferred to it. If the defendant pleads this defense in the litigation, the defendant will thus be shielded from liability.

II. English Translations

The English translations of § 146(1) German Insolvency Act and of § 195 German Civil Code, published on the Web site of the (German) Federal Ministry of Justice, read:

§ 146(1) German Insolvency Act:

> "Section 146 -- Limitation of the Right to Contest
>
> (1) The right to contest a transaction shall be subject to the regulations governing regular limitation under the Civil Code."

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69 As opposed to American bankruptcy law (cf. Section 546(a) and Section 550(f) B.C.), German insolvency law does not separate the avoidance of the transaction and the recovery from the transferee. In consequence, there is only one statute of limitations that applies.

§ 195 German Civil Code:

"Section 195 -- Standard limitation period
The standard limitation period is three years."

Question 5

Statute of Limitations: Beginning

On what date does the applicable statute of limitations begin to run under Sections 131, 134, and 133 of the German Insolvency Law?

Report on Question 5

I. Commencement of the Standard Limitation Period

The Civil Code's standard limitation period begins to run at the end of the year in which the claim arose *and* the plaintiff learned of the facts giving rise to the claim or would have learnt of these facts had the plaintiff not ignored them in gross negligence (§ 199(1) German Civil Code).

The earliest date on which the standard limitation period, as applied to the remedies of avoidance law, can begin to run is the end of the year in which the insolvency receiver was appointed.[70] Since the insolvency receiver is the person whose knowledge is required by § 199(1) German Civil Code, the standard limitation period cannot begin to run before its appointment. In our case, Plaintiff was appointed on Nov. 1, 2009.[71] Thus, the earliest date possible (for the beginning of the period) is Dec. 31, 2009 (which would imply that the period ended on Dec. 31, 2012).

However, the period does not begin to run before the end of the year in which the insolvency receiver gained actual or constructive knowledge of the facts which made the transaction voidable under insolvency law. In § 199(1) German Civil Code, constructive knowledge requires more than the violation of due diligence. It does not suffice that the insolvency receiver would have discovered the relevant facts with reasonable efforts. Rather, gross negligence is required: The insolvency receiver failed to exercise even the slightest care in administering the insolvency estate. The insolvency receiver could avoid learning of the relevant

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70 Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Volume 4, 2008, § 146 ¶ 11.

71 Amtsgericht München (Municipal Court Munich), Nov. 1, 2009, 1507 IN 2731/09.

facts only by ignoring all signs that unmistakably point to the relevant facts; the receiver treated these signs with complete indifference.[72]

The knowledge of the insolvency debtor may not be attributed to the insolvency receiver.[73]

Being a defense, it is for the defendant to state and to prove that the statute of limitations has run.

II. English Translation

The English translation of § 199(1) German Civil Code, published on the Web site of the (German) Federal Ministry of Justice, reads:

"Section 199 -- Commencement of the standard limitation period and maximum limitation periods

(1) Unless another commencement of limitation of is determined, the standard limitation period commences at the end of the year in which:

1. the claim arose

and

2. the obligee obtains knowledge of the circumstances giving rise to the claim and of the identity of the obligor, or would have obtained such knowledge if he had not shown gross negligence."

III. Plaintiff's Amended Complaint: Statute of Limitations

1. Defendant Pier

Defendant Pier does not assert that the statute of limitations has run.

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72 Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Volume 4, 2008, § 146 ¶ 12.

73 Jaeger (Henckel), Insolvenzordnung, Großkommentar, 1st edition, Volume 4, 2008, § 146 ¶ 11.

2. Defendant HS Asset

Plaintiff extended his avoidance action to Defendant HS Asset in 2013; the Amended Complaint was filed on Apr. 10, 2103.[74] At this time, the Civil Code's standard limitation period would have been expired if Plaintiff got to know all relevant facts in 2009 (in which case the period would have ended on Dec. 31, 2012).

In his suit against HS Asset, Plaintiff pleads different factual scenarios: for a claim under § 131 German Insolvency; and for a claim under § 134 German Insolvency Act; and, possibly, for a claim under § 133 German Insolvency Act.

a) Factual Scenario: HS Asset as Creditor of Escada AG; § 131 German Insolvency Act

Defendant HS Asset pleads the statute of limitations defense specifically against Plaintiff's claim under § 131 German Insolvency Act (Defendants, Motion to Dismiss Amended Complaint, May 15, 2013, Document 12, p. 2; Defendants, Memorandum May 15, 2013, Document 13, p. 12).

The facts which give rise to Plaintiff's claim under § 131(1) German Insolvency Act include: HS Asset was an unsecured creditor of Escada AG; by initiating the Payment, Escada AG performed its debt to HS Asset; further facts.[75]

There is nothing in the Amended Complaint (or in the statements by the Defendants) which suggests that Plaintiff learnt of these facts already in 2009.

As regards Plaintiff's claim under § 131 German Insolvency Act against HS Asset, the statute of limitations has not run at the time of the filing of the Amended Complaint.

b) Factual Scenario: HS Asset Not a Creditor of Escada AG; § 134 and possibly § 133 German Insolvency Act

As regards this factual situation, I am not able to determine whether the statute of limitations has run.

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74 The issue of "relation back" is a matter of American law.

75 Report on Question 1, parts A and B II.

I will assume that Defendant HS Asset raises the statute of limitations defense not only against the claim under § 131 German Insolvency Act, but also against the other grounds of avoidance relied on by Plaintiff, such as § 134 and, possibly, § 133 German Insolvency Act.

But this is not entirely clear.

In the "Motion to Dismiss Amended Complaint", Defendant HS Asset asserts that "Plaintiff is time-barred from asserting claims against Defendant HS Asset" (Document 12, filed May 15, 2013, p. 2), thereby referring, it seems to me, to all avoidance claims made by Plaintiff.

However, in the "Memorandum in Support of Motion to Dismiss Amended Complaint", Defendant HS Asset seems to raise the statute of limitations defense only against § 131(1), but not against the one based on § 134 German Insolvency Act (Document 13, May 15, 2013, pp. 12-17).

This issue is governed by American law.

The facts which might give rise to the avoidance remedy of § 134 German Insolvency Act (but eventually do not) include: Pier received the Funds as a fiduciary of HS Asset; HS Asset was a creditor of Escada USA; by initiating the Payment, Escada AG performed the debt owed by its subsidiary Escada USA to HS Asset; further facts.[76]

If the Amended Complaint had stated a claim of relief under § 134 German Insolvency Act, Defendant HS Asset's statute of limitations defense would require that Plaintiff knew all relevant facts already in 2009.

The Amended Complaint and the facts stated therein do not support the conclusion that Plaintiff had the required knowledge in 2009. From the Amended Complaint it appears that Plaintiff first learnt of the facts that Pier received the Funds on behalf of HS Asset, and that HS Asset was the party to the Owner-Manager Agreement with Escada USA, with the receipt of the March 7 Letter in 2013.

However, there are two documents which might be judicially noticeable and indicative of Plaintiff's knowledge in 2009.

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76 Report on Question 2, parts A and B II.

-- List of Assumed Contracts, filed in the Escada USA's Chapter 11 case in 2009: This list was not part of the documents sent to me; it is referred to by the Lüke Expert Report.[77] -- The entry of HS Asset in a list of this kind informs the reader that a contract with HS Asset has been assumed pursuant to Section 365 B.C. It is hard to conceive that this entry carries any additional information such as that the Funds paid by Escada AG to Pier in 2009 performed a debt owed by Escada USA to HS Asset. It also does not appear to back a judgment of gross negligence against Plaintiff.

-- In 2009, Plaintiff, on behalf of Escada AG, filed an unsecured claim for USD 37 million in Escada USA's Chapter 11 case ("Gerloff Proof of Claim"). Defendants allege that this claim included the sum of the Payment.[78] If this filing is "judicially noticeable" (matter of American law),[79] the filing would need to be reviewed whether it states that Pier (to whom the Payment was made) acted as a fiduciary of HS Asset, and whether it states that the Payment was made in performance of a debt owed by Escada USA to HS Asset. Again, this appears to be unlikely. But since I do not know this filing, I cannot answer these two questions.

I arrive at the conclusion that the statute of limitations defense of Defendant HS Asset against § 134 German Insolvency Act depends on the details of further documents, provided these documents are judicially noticeable.

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77 Lüke Expert Report, filed July 25, 2013, Document 24, English version, p. 28. -- I received a document titled "Final List of Assumed Contracts" (Document 15-6, filed May 15, 2013). But this list dates from 2010 and does not allow inferences for Plaintiff's knowledge in 2009.

78 Defendants, Memorandum May 15, 2013, Document 13, p. 15. The document referred to by Defendants ("Mears Aff.") does not belong to the documents sent to me.

79 Denied by Plaintiff, Memorandum July 24, 2013, Document 20, pdf-p. 19.

Question 6

"Equity and Good Conscience"

What must a Plaintiff prove to state a claim for "equity and good conscience" under German law? Does Plaintiff's [Amended] Complaint state a claim for "equity and good conscience" under German law?

Report on Question 6

I. The Good Faith Principle

The principle of good faith, codified in § 242 German Civil Code, may both create new rights (which have no basis in other legal rules) and limit existing rights (established by other legal rules).[80] The principle intervenes where the application of other legal rules leads to results that are unbearable, as they violate basic notions of justice and fairness. In order to extract more specific content from the good faith principle, German jurisprudence distinguishes various fact patterns in which the principle might apply. The agency by estoppel may serve as an example: Here the principal acted in such a way as to lead a third party to reasonably believe that another person is the principal's agent and the third party relied on this belief.[81] In German law, this type of agency is derived from the good faith principle.[82] Since the factual scenarios stated in Plaintiff's Amended Complaint do not come within the scope of any of the recognized fact patterns, there is no need to present these fact patterns in this Report.

II. English Translation

The English translation of § 242 German Civil Code, published on the Web site of the (German) Federal Ministry of Justice, reads:

"Section 242 -- Performance in good faith

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80 Münchener Kommentar zum Bürgerlichen Gesetzbuch (Roth / Schubert), 6th edition, Vol. 2, 2012, § 242 ¶¶ 2 and 198, citing further references.

81 Definition taken from Merriam-Webster's Dictionary of Law, 2011.

82 Münchener Kommentar zum Bürgerlichen Gesetzbuch (Roth / Schubert), 6th edition, Vol. 2, 2012, § 242 ¶¶ 308 and 314.

An obligor has a duty to perform according to the requirements of good faith, taking customary practice into consideration."

III. Plaintiff's Amended Complaint

Plaintiff's Amended Complaint does not state a claim under the good faith principle of German law (§ 242 German Civil Code).

The application of the rules of avoidance law does not lead to results that violate basic notions of fairness and justice.

-- As regards the fact situations "Pier a creditor of Escada AG" and "HS Asset a creditor of Escada AG", Plaintiff states a claim under § 131 German Insolvency Act against each Defendant.[83] There is no room for invoking the principle of good faith on behalf of Plaintiff.

-- As regards the fact situation "Pier no creditor of Escada AG", Plaintiff states a claim of relief under § 134 German Insolvency Act.[84] Again, there is no room for applying the good faith principle on behalf of Plaintiff.

-- As regards the fact situation "HS Asset no creditor of Escada AG", the Amended Complaint fails to state a ground of avoidance, because HS Asset was not the "recipient" of the Funds (but Escada USA was).[85] This result does not run afoul general notions of fairness. On the contrary: If HS Asset were held liable under the avoidance rules, although Escada USA was the "recipient" of the Funds, consequences grossly unfair to HS Asset might ensue. The Funds would be deemed the property of Escada USA (as the beneficiary according to the Owner-Manager Agreement) and the property of Escada AG (because of the voidableness of the Payment), a legal determination which is bound to impose contradictory duties on HS Asset.

There are no other grounds which would call for an intervention of the good faith principle. In particular, neither Pier nor HS Asset acted in such a way as to make either Plaintiff

83 Report on Question 1.

84 Report on Question 2, part B I.

85 Report on Question 2, part B II (§ 134 German Insolvency Act) and Report on Question 3, part B II (§ 133 German Insolvency Act).

or Escada AG believe that it would commit itself to repay the Funds transferred to it. In fact, the Amended Complaint does not state any dealings or other forms of interaction between Pier or HS Asset and Escada AG or the Plaintiff prior to this lawsuit.

Question 7: Other Points

Are there other points of German law that you believe the Court should understand in order to make its decision?

Report on Question 7

I think all points of relevance to Plaintiff's claim are covered by the Reports to Questions 1-6.