

SCHULTZE & BRAUN INSOLVENCY LAW

The new right of avoidance and contestability – debtor’s right to contest legal acts during insolvency proceedings

As soon as debtors find themselves in a crisis situation, it is quite common that asset shifting takes place during the weeks and months before the insolvency filing, a course of action which is incompatible with the fundamental principles of insolvency proceedings. For instance, creditors who either enjoy particularly good relationships with the debtor or its director, or who have the appropriate means to apply strong pressure, often receive payments from the debtor, while other insolvency creditors come away empty-handed. This contradicts the basic principle of insolvency handling which states that all creditors must be treated equally (*par condicio creditorum*).

Even more questionable is the practice whereby debtors, who have realised that they can no longer satisfy their creditors, try to hide away some of their assets by transferring these to third parties (family members, friends, other straw men) and so denying creditors access to these assets. Quite apart from the relevance under criminal law of such actions¹, this also contradicts the underlying principle of the insolvency code which says that the debtor’s entire (attachable) assets must be utilised and the proceeds distributed among the creditors (§§ 1, 36 InsO)².

To be able to undo such assets shifts to the detriment of the creditors, the insolvency code relies on the option of “insolvency contesting”³. Insolvency contesting as such has nothing to do with the provisions of §§ 119ff BGB (Civil Code) providing for the rescindment of the legal consequences of a declaration of intention, instead, it is aimed at the return of indebted assets given away ahead of the insolvency.

Changes in the contesting regulations made by the insolvency code

Until the insolvency code came into force on 1 January 1999, the contesting regulations were contained in §§ 29ff of the bankruptcy code or, respectively, in § 10 of the collective execution code, whereas the contesting option was not available at all in composition proceedings. The previous contesting regulations of the bankruptcy code and the collective execution code were, in many cases, so demanding in terms of their specific requirements that contesting was virtually doomed to fail.⁴ In practice, the contesting regulations often made non-provable demands on the subjective knowledge of the avoidance opponent. Also, the periods within which these actions had to be taken in order to allow the contesting, and the exclusion period of one year after the opening of the proceedings within which the bankruptcy trustee had to assert the contesting, often proved to be far too tight. The insolvency code has eliminated these shortcomings and has, in some instances, substantially tightened the contesting regulations.⁵

¹ Cf. §§ 283ff StGB (Criminal Code)

² Unless the creditors do not have a sufficient majority in an insolvency schedule to arrive at a diverging settlement (§ 1 InsO). Cf. in detail: *Der Syndikus*, 16th issue November/December 2000, 27ff.

³ §§ 129ff InsO. Similar regulations for contesting outside insolvency proceedings also exist in the avoidance law amended on 1 January 1999.

⁴ Cf. the reasons given for the government draft on §§ 129ff InsO, printed in Kübler/Prütting, *Das neue Insolvenzrecht*, 1999, 335ff.

⁵ Cf. Paulus / Schröder, *WM* 1999, 253ff.

Basic structure of the contesting regulations

Definition of the term “legal act”

The facts of the insolvency contesting tie in regularly with a legal act. In this, the term legal act is to be interpreted generously to include any unlawful defeating of creditors and asset shifts, as the case may be. These also include, for instance, judicial execution acts, judicial divisions of net assets and asset and property shifts resting on a court ruling.⁶

Defeating of creditors

Furthermore, the legal act must have resulted in a defeating of the creditor. This means that the satisfaction of the creditor is impaired by the legal act. Defeat of the creditors therefore always prevails if the legal act contested causes the insolvent assets to be economically worse off than it would have been without such legal act. It is regularly sufficient that the defeat is not itself caused by the legal transaction to be contested, but by circumstances occurring later. The sale of a plot of land, for instance, can therefore also be challenged for reasons of being a deliberate defeat if the selling price has been commensurate, but if the debtor had the intention of withholding the money from the creditors⁷ (and eventually realises this intention).

Return to status quo ante

The objective of contesting within insolvency is the return of the debtor’s assets sold, given away or abandoned (§ 143 InsO). As the contesting is intended to return the insolvent assets to the state in which they would have been, had the contestable action not been taken, the effectively contested purchase is therefore to be returned “in natura” to the insolvent estate.⁸

Complying with the principle that the insolvent assets are merely to be returned to their original state (and not to be improved), the claim by the avoidance opponent (satisfied by the contestable act) is again revived (§ 144 Section 1 InsO). Any consideration paid must be reimbursed from the insolvent estate. To the extent the consideration of the estate is no longer distinguishably available, or the estate has no longer been enriched by the value, the avoidance opponent may assert his claim for reimbursement of the consideration only in his capacity as insolvency creditor (§ 144 Section 2 InsO).

Exercise of the insolvency contesting and avoidance right

On principle, the insolvency contesting and avoidance right is exercised by the insolvency administrator (§ 129 Section 1 InsO). During the insolvency proceedings, the individual insolvency creditors have no personal contesting rights.

Principal facts of the insolvency contesting regulations

§§ 129ff of the insolvency code contain a wealth of individual facts for contesting, with the following four considered the most important cases:

Special insolvency contesting

Special insolvency contesting actions are regulated in §§ 130 and 131 InsO. According to these paragraphs, a legal act in which an insolvency creditor has granted a security interest or a satisfaction during the last three months prior to the insolvency proceedings, is contestable under

⁶ Cf. the reasons given for the government draft on §§ 129ff InsO, printed in Kübler/Prütting, *ibid.*, 336ff.

⁷ See footnote 6

⁸ Cf. the reasons given for the government draft on §§ 143 InsO, printed in Kübler/Prütting, *ibid.*, 358ff.

certain conditions. The provisions draw a distinction between “congruent coverage”, i.e. one to which the creditor had an actual claim, and “incongruent coverage” which the creditor was not permitted to claim at all or not in the manner or the time in which it was made. The requirements involving incongruent coverage are substantially less stringent than those for congruent coverage.

Incongruent coverage

An incongruent coverage (§ 131 InsO) made during the last month before filing for insolvency or after the application is therefore contestable without any qualification. There are no special requirements as to the facts of the case. If the act takes place within the second or the third month prior to the opening application, it is contestable if the debtor has either been unable to pay at the time of the act, or if the creditor has known that the act would defeat the insolvency creditors.

Congruent coverage

On the other hand, the congruent coverage (§ 130 InsO) is contestable only if it has been made during the last three months prior to the application for opening the insolvency proceedings and if – cumulatively – the debtor has been unable to pay at the time of the act and the creditor has been aware of the inability to pay.⁹

If the incongruent coverage has been completed by way of compulsory execution during the last month prior to the insolvency application, contesting is not required. These measures become ineffective *ipso iure* upon the opening of the proceedings (§ 88 InsO).

Contesting for reasons of intentional defeat

§ 133 InsO regulates the contesting for reasons of intentional defeat. According to this provision, the insolvency administrator may contest actions which the debtors has undertaken with the intention of defeating his creditors if the other party/parties have been aware of the debtor’s intentions at the time of the act. The creditor’s knowledge is assumed if he has been aware that the debtor was under threat of inability to pay and that this act defeated the creditors (§ 133 Section 1 No. 2 InsO). Pursuant to this provision, acts by the debtor during the last ten years prior to the application for opening insolvency proceedings or thereafter are contestable. Under these conditions and those of § 133 InsO, incongruent coverages can also be contested outside the three-month’s period of § 131 InsO. It should be noted in this context that the law sees the existence of an incongruent coverage as particularly strong evidence of the intention to defeat the creditors.¹⁰

Contesting for reasons of gratuitous performances

According to § 134 InsO, the debtor’s gratuitous performances rendered within the last four years prior to the application for opening insolvency proceedings are contestable, the reason being the lower inventory impact of gratuitous acquisitions.¹¹ No-one should be allowed to be generous at his creditors’ expense.

⁹ The same applies to act after the opening application if the creditor has been aware of the inability to pay and the opening application at the time of the act (§ 130 Section 1 No. 2 InsO).

¹⁰ BGH (Federal Court of Justice), ruling dated 30 January 1997, ZIP 1997, 513ff.

¹¹ Cf. the reasons given for the government draft on §§ 134 InsO, printed in Kübler/Prütting, *ibid.*, 349.

Contesting performances involving capital-replacing loans

Finally, § 135 InsO regulates the contestability of performances on capital-replacing loans.¹² To the extent such a creditor has been granted satisfaction, such act is contestable if it has been made in the last year prior to the application or thereafter. And if such creditor has been granted a security interest, the act is contestable even if the security interest has been created within the last ten years prior to the application to open insolvency proceedings (§ 135 No. 1 InsO).

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¹² Pursuant to § 32 a Section 1 GmbHG, capital-replacing loans are loans which a partner of a company has granted at a time at which the partners would have injected equity as prudent businessmen. This is always the case if the company is over-indebted, insolvent or otherwise unworthy of credits. Cf. in detail the commentaries on § 32 a/b GmbHG, e.g. by Lutter / Hommelhoff, *GmbHG*, 15th edition 2000, § 32 a/b