

## Germany: Insolvency Claw-back Reform Provides Some Relief for Creditors

***The reform of claw-back rights in German insolvency proceedings which provides for more legal certainty for creditors has become effective on 5 April 2017.***

Following their interpretation by German courts, the claw-back rights under German insolvency law left creditors with severe risks and legal uncertainties if they granted deferrals or other payment accommodations to distressed debtors as they had to fear that any subsequent payments they received could be challenged (up to ten years prior to a filing for opening of insolvency proceedings over the assets of the debtor). On 16 February 2017 the German parliament (*Bundestag*) adopted the reform of the claw-back provisions which now provides for a better balance of interests among creditors in insolvency proceedings. On 10 March 2017, the reform passed the German federal assembly (*Bundesrat*) and has now become effective.

### Background

Claw-back rights are intended to support the equal treatment of creditors by undoing property transfers which were made to any creditors at the expense of the insolvency estate before the opening of insolvency proceedings. If an insolvency administrator successfully challenges payments to a creditor, this creditor must repay all of the payments made during the respective hardening period, leaving the creditor with an unsecured insolvency claim.

### Prior to the Reform

Creditors that granted payment accommodations, such as deferrals or payments in instalments, to allow the debtor to overcome temporary payment difficulties had to face the risk of an insolvency administrator making claw-back claims (*Vorsatzanfechtung*, sec. 133 Insolvency Code) in respect of subsequent payments.

German courts interpreted this provision very broadly and concluded that the conditions for such repayment or claw-back claims were satisfied if the debtor and the creditor were aware of the debtor's (imminent) illiquidity. Moreover, the courts presumed both the creditor and the debtor were aware of the imminent illiquidity if they entered into an agreement on payment accommodations. This presumption was clearly inconsistent with the business practice, since most creditors actually assumed the debtor would not be or would not remain illiquid after the creditor had granted deferrals (since a deferral is intended to help a debtor to avoid an illiquidity). The courts' interpretation coupled with the 10-year hardening period for such claw-back rights, resulted in immense risks and legal uncertainty for creditors.

If an insolvency administrator successfully challenged payments, the creditors were required to return the payments and also to pay default interest accruing from the opening of insolvency proceedings, even if the insolvency administrator challenged the payments much later in the process. Insolvency administrators therefore had been incentivized to challenge the payments at a late stage of the insolvency proceedings, while the creditors who did not know about an insolvency administrator's intent to challenge the payments had no chance to fulfill the claw-back claim in "advance" in order to avoid also paying default interest.

## **Main Amendments**

The adopted reform provides for the following essential amendments:

### **Privilege for agreements on payment accommodations**

Entering into an agreement on payment deferrals or other accommodations with the debtor will no longer automatically trigger a disadvantage for the creditor. To the contrary, payment accommodation agreements will constitute the presumption that the respective creditor was not aware of the debtor's illiquidity.

### **Reduction of hardening period for certain legal acts from 10 years to four years**

If the challenged legal act (payment or property transfer) occurred in fulfilment of a claim or as security for a claim, the maximum hardening period will be shortened from 10 years to four years.

### **Interest period for claw-back claims**

The default interest period will no longer start before the creditor is in payment default, e.g. if the creditor refuses to pay after the insolvency administrator asked for payment based on its claw-back right. Therefore, creditors can avoid interest accruals by payments or deposits (where sensible).

### **Privilege for employees' wages**

Employment wages are privileged under the claw-back provisions if they are paid within three months after the employee's performance by (i) the employer or (ii) any third party if it is not clear for the employee that the payment came from a party other than its employer.

## **Conclusion**

After a long period of discussion amongst legal experts, the reform is the right move. It improves the balance of interests among creditors and provides for more legal certainty for creditors facing distressed debtors.

Nevertheless, claw-back rights in insolvency proceedings remain a challenging legal field. Creditors need to consider the relevant case law and anticipate future judgements with respect to the new claw-back provisions. The legal risks can be so serious as to jeopardize a creditor's economic existence. Nevertheless, claw-back risks can be mitigated in a thorough process prior to insolvency proceedings. Creditors who receive payments that are challenged or who want to mitigate any claw-back risks in advance should consult with counsel.

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If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

**Frank Grell**

frank.grell@lw.com  
+49.40.4140.3254  
+49.173.204.3567  
Hamburg

**Jörn Kowalewski**

joern.kowalewski@lw.com  
+49.40.4140.3237  
+49.171.330.3737  
Hamburg

**Ulrich Klockenbrink**

ulrich.klockenbrink@lw.com  
+49.40.4140.335  
+49.177.673.4165  
Hamburg

**Janina Keßler**

janina.kessler@lw.com  
+49.40.4140.3164  
+49.171.9076.872  
Hamburg

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