

## Insolvency & Restructuring - Germany

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### Courts accept transferability of restitution claims resulting from clawback

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#### Introduction

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#### Comment

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In insolvency proceedings, the creditors' main interest is in having the insolvency administrator maximise the insolvency estate and then distribute the proceeds among the creditors. Under German insolvency law, the insolvency estate is protected from any influence other than the administrator's as soon as insolvency proceedings have been opened.

However, the debtor might have disposed of some of its assets before the opening of proceedings. If this was done to the disadvantage of certain creditors, in certain cases (eg, gratuitous benefits or wilful disadvantage) the Insolvency Act renders the relevant transactions contestable. If the insolvency administrator chooses to contest such transactions, the legal consequence will be a claim for restitution against the recipient of the debtor's assets.

Yet even if successful, the administrator may not want to maintain the claim, but rather sell it to a third party. As opposed to the costly pursuit of a court decision, this would benefit the insolvency estate with regard to both time and money. However, further to a decision of the Court of the German Empire in 1893 the prevailing view in the German courts and among legal scholars has been that the transfer of such claims for restitution is not permissible. It has traditionally been argued that the purpose of these claims is to restore the debtor's assets, which means that anything transferred by the debtor in violation of insolvency laws would still be considered as part of the insolvency estate. The claim would therefore be personally connected to the insolvency estate and the person of the insolvency administrator, leading to a prohibition of its assignment under the general rules of German civil law.

#### Federal Court of Justice ruling

This position changed following a decision of the Federal Court of Justice issued on February 2 2011. The court held that the transfer of claims against recipients of contestable transactions is now permissible.

In the case at hand, the director of a German limited liability company on the brink of insolvency had used the company's assets to back his own pension scheme. The insolvency administrator challenged this transaction, but chose to sell the subsequent claim for restitution. The director later argued that the party acquiring the claim had no standing to bring suit, as it was not permissible for the insolvency administrator to transfer claims resulting from contested transactions.

In overruling the earlier decision, the Federal Court of Justice held that such a transfer can in fact be valid. The court argued that the purpose of claims for restitution under insolvency law is merely to reverse certain unlawful changes to the insolvency estate. This purpose can be served not only by regaining a particular piece of the insolvency estate, but also by obtaining its monetary value. Accordingly, the court also held that such claims must not be sold substantially below their worth.

#### Comment

From an economic perspective, this ruling allows for greater flexibility. When faced with a contestable transaction, the insolvency administrator now has a second option to satisfy the creditors. Instead of pursuing any claims for restitution before a national court, it may choose to sell them in order to increase the value of the insolvency estate immediately. Even if the result is only a fraction of the claim's actual worth, the loss might still fall short of the costs of having to seek a court decision.

The recipient of the contested transaction, on the other hand, must tolerate a change of creditors. Further, the recipient's counterclaim will lose value, as the third party will contribute only a fraction of the administrator's claim to the insolvency estate. However, as it is still not permissible to sell claims at more than a slight discount, the creditors' financial interests should also be protected. As a result, the change in the court's position allows for increased economic flexibility and efficiency during insolvency proceedings.

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