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KNOWLEDGE NUGGETS

INCONGRUENT COVERAGE (SECTION 131 INSO) – WHEN PAYMENTS MADE UNDER PRESSURE BACKFIRE

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I. WHY THIS TOPIC IS IMPORTANT

The fundamental principle of German insolvency law is the equal treatment of creditors. The insolvency avoidance rules are designed to reverse transfers of assets made prior to the opening of insolvency proceedings that disadvantage creditors, thereby increasing the insolvency estate. Section 131 of the German Insolvency Code (*Insolvenzordnung*, InsO) addresses so-called "incongruent coverage" (*inkongruente Deckung*): The insolvency administrator may avoid the granting of security or satisfaction to a creditor that was not entitled to receive it, or was not entitled to receive it in that form or at that time.

The practical implications are significant: In the case of an avoidance action under Section 131 InsO, objective incongruence within the last month prior to the filing of the insolvency petition (or thereafter) is sufficient—no subjective requirements (the creditor's knowledge of the debtor's insolvency) are necessary. This considerably increases the risk of recovery for payment recipients, particularly when payments are made under pressure, following reminders, or to avert an insolvency petition or enforcement proceedings.

Typically affected are suppliers, banks, and other creditors who received security or satisfaction from a debtor in crisis under unusual circumstances (e.g., late, in a different form, or before the due date). Furthermore, according to the established case law of the Federal Court of Justice (*Bundesgerichtshof*, BGH), the so-called "cash transaction privilege" (*Bargeschäftsprivileg*) does not apply in cases of incongruent coverage—incongruent transactions therefore always remain subject to avoidance, even where an economically equivalent exchange of performance has taken place.

II. REQUIREMENTS FOR AVOIDANCE UNDER SECTION 131 INSO

Avoidance under Section 131 InsO requires that the debtor has granted a creditor security or satisfaction that the creditor was not entitled to receive, or was not entitled to receive in that form or at that time. The specific requirements are as follows:

- **Concept of Incongruent Coverage:** Security or satisfaction is incongruent if the creditor had no enforceable claim to it, had no claim to it in that form, or had no claim to it at that time. Examples include: satisfaction of a time-barred claim, satisfaction provided in a manner deviating from the content of the contractual obligation, satisfaction of a claim before its due date, or payments made under pressure or threat.
- **Avoidance Periods (staggered):** If the legal act was performed within the last month before the filing of the insolvency petition (or thereafter), no further subjective requirements apply—objective incongruence alone is sufficient. For acts performed in the second and third months prior to the filing of the insolvency petition, avoidance is possible only if the debtor was already unable to pay its debts (*zahlungsunfähig*) at the time of the act or if the creditor knew that the act would disadvantage the other insolvency creditors.
- **Legal Consequences:** A successful avoidance action gives rise to an obligation to return the benefit received to the insolvency estate (*schuldrechtlicher Rückgewähranspruch zur Insolvenzmasse*), which becomes due upon the opening of insolvency proceedings and accrues default interest upon demand by the insolvency administrator. In principle, restitution in kind is owed; if the avoidance defendant returns what was obtained, their original claim is revived. However, this revived claim is typically only an ordinary insolvency claim (*Insolvenzforderung*), meaning the avoidance defendant will, at most, receive a pro rata dividend from the insolvency estate—which is typically rather low.

III. RECOMMENDATIONS

- **Strictly adhere to contractual payment terms:** Accept only payments or security that correspond exactly to the contractually agreed claim in terms of type, timing, and scope. Any deviation (early payment, different form of performance, payment against a time-barred claim) constitutes incongruent coverage.
- **Exercise caution with pressure payments:** Do not demand payments through unjustified reminders, threats of enforcement, or announcements of an insolvency petition. Such "coerced" payments (*Druckzahlungen*) are considered incongruent and can be readily avoided within the last month prior to the filing of the insolvency petition.
- **Monitor creditworthiness and payment behavior:** If there are indicators of financial difficulties on the part of the debtor (e.g., repeated payment delays, requests for installment arrangements, enforcement measures by third parties), verify whether any offered security or satisfaction corresponds to what was contractually agreed.
- **Do not rely on the cash transaction structure and keep the possibility of avoidance in mind:** Note that the cash transaction privilege (*Bargeschäftsprivileg*) does not apply to incongruent coverage according to the case law. An economically balanced transaction does not protect against avoidance if it is incongruent. Always consider that benefits received in an avoidable manner may have to be returned.
- **Document the due date and basis of the claim:** Carefully document when and in what form a claim arose under the contract and when it became due, in order to demonstrate the congruence of any consideration received in the event of avoidance proceedings.
- **Exercise particular caution with related parties:** Note that for shareholders, members of corporate bodies, and other related parties (*nahestehende Personen*), knowledge of the disadvantaging of creditors is presumed. This presumption significantly facilitates avoidance actions in practice.
- **Seek legal advice early:** Have any security or payments received from a contracting party in crisis reviewed promptly by specialized attorneys to assess the risk of avoidance (*Anfechtungsfestigkeit*) and develop appropriate risk mitigation strategies.