



EURAVOCAT LAW HANDBOOK

DEBT COLLECTION IN GERMANY

From our member in Stuttgart



1. Amicable collection

In Germany, monetary claims may first and foremost be recovered amicably.

The process of recovering a debt usually begins with the creditor sending one (or several) dunning letters/reminders to the debtor demanding payment of the amount due.

In addition to the speed of an out-of-court debt collection and the favourable costs, one reason for this approach versus immediately initiating legal action against the debtor is provided by Section 93 of the German Code of Civil Procedure (ZPO - Zivilprozessordnung). Thereafter, where the defendant has not given cause for an action to be brought, the plaintiff shall bear the costs of the proceedings should the defendant immediately acknowledge the claim. In principle, the debtor gives a cause of action if he did not fulfil the later acknowledged claim before the proceedings, although the claim was due, and the plaintiff sent a dunning letter according to Section 286 of the German Civil Code (BGB - Bürgerliches Gesetzbuch) - unless such letter is dispensable exceptionally, e.g. when the parties agreed on a fix payment term or when the debtor definitively refuses performance. Thus, as a general rule, if the creditor files legal action against the debtor without having sent a dunning letter beforehand, the debtor may acknowledge the claim and shift the obligation to bear the cost of the proceedings (court and lawyers' fees) to the creditor. In order to minimise the expense and risk, it is therefore highly advisable to first issue an extrajudicial dunning letter. It is not necessary to point out that in the event of fruitless expiry of the reasonable grace period, legal action will be taken.

As regards the content of a dunning letter, such letter must outline the outstanding debt, state the underlying facts and set a reasonable deadline for payment. If the debtor fails to pay until expiry of the set deadline, then he is in default of payment. Regardless of a dunning letter, default of payment occurs at the

latest if the debtor fails to perform within 30 days after the due date and receipt of an invoice or equivalent statement of payment.

One main consequence of being in default for the debtor is that he must bear interest on the debt. According to Section 288 of the BGB, the default interest rate for consumers is 5 percentage points above the base interest rate of the European Central Bank. In B2B transactions, the default interest rate is 9 percentage points above the base interest rate. In addition, the creditor is also entitled to payment of a lump sum in the amount of 40 €. Of course, if higher late payment charges have been agreed in the individual contract or must be paid to the creditor's bank, these can be charged as damages.

The general prescription period under German law is three years, starting at the end of the year a claim becomes due. Limitation can inter alia be suspended or recommenced in case of negotiations or introduction of judicial proceedings.

2. Judicial collection

If amicable collection efforts prove unsuccessful, the creditor can escalate the matter to the judicial phase. Here the creditor has two options:

Judicial dunning procedure (Mahnverfahren)

The judicial dunning procedure is a legal process designed to facilitate the collection of unpaid debts.

It's a preliminary enforcement measure that aims to expedite the collection process by providing creditors with a relatively swift and cost-effective way to obtain a writ of execution (Vollstreckungsbescheid). The duration of dunning procedure is approx. 12 weeks. This writ of execution enables the creditor to take further enforcement actions to recover the debt owed by the debtor. The procedure begins with the creditor submitting an electronic application for a payment order (Mahnbescheid) to the competent court. Evidence must not be presented, yet the claim must be asserted conclusively. The court issues a payment order without a formal hearing and sends it to the debtor. Upon receiving the payment order, the debtor has two weeks to raise objections against the asserted claim. If the debtor files an objection within this timeframe, the case will proceed to regular court proceedings, and the creditor will need to decide whether to pursue a lawsuit to recover the debt. Otherwise, the creditor may apply issuance of a writ of execution (Vollstreckungsbescheid). This writ allows the creditor to take enforcement actions to recover the debt. The writ of execution can be used to garnish wages, seize assets, or take other measures specified by the enforcement laws.

The objection to the payment order does not have to be substantiated by the defendant. All in all, the judicial dunning procedure should be pursued where the creditor assumes that the debtor will not object. If the debtor objects to the payment or execution orders, ordinary legal proceedings will be required.

Ordinary legal action

On the other hand, If the creditor knows or finds it likely that the claim will be disputed it is generally reasonable to file a lawsuit.

Procedure

Legal action must be brought to either a local Court (Amtsgericht) or the District Court (Landgericht), depending on the amount in dispute. The local Court is competent when the amount in dispute is below 5,000 €.

The legal proceedings usually start with a written procedure. Both the plaintiff and the defendant must exchange opinions and provide evidence for their assertions. The court will then schedule a hearing. According to the German Code of Civil Procedure the court is to act in the interests of arriving at an amicable resolution of the legal dispute and therefore the hearing is always preceded by a conciliation hearing. Should the conciliation hearing not meet with success, the regular hearing will be held immediately thereafter.

The court is then to decide, at its discretion and conviction, and taking account of the entire content of the hearing and the results obtained by evidence being taken, if any, whether an allegation as to fact is to be deemed true or untrue.

Court proceedings can take 12 months or even longer in first instance.

Appeals

Appealing against judgments is possible. In second instance the appeal can be based on facts and law, whereas in third instance, the review will be limited to the correct application of laws.

Fees

In civil proceedings, the party that has not prevailed in the dispute is to bear the costs of the legal dispute, i.e. the court fees as well as the statutory fees and expenditures of the opponent's attorney. Where each of the parties has prevailed for a part of its claim, but has not been able to enforce another part of its claim in the dispute, the costs are generally to be shared proportionately. The statutory court and the statutory lawyers' fees are determined by law and graduated according to the amount in dispute. It is possible to make a fee agreement with one's own client that deviates from the statutory fees, e.g. settlement according to an hourly rate, but in civil proceedings the statutory fees are always applied.

Enforcement

With a court judgment in hand, the creditor can initiate enforcement measures to recover the debt and can enforce in movable or immovable property. This may include garnishing the debtor's wages, seizing assets, freezing bank accounts, or sequestering real estate.

3. Insolvency of the debtor

Insolvency proceedings are a kind of collective enforcement by all the creditors against the debtor. One must differentiate between insolvencies of natural persons and insolvencies of legal entities. In the following, we focus on corporate insolvencies.

General information

The primary purpose of insolvency proceedings is to satisfy a debtor's creditors collectively by realizing the debtor's assets and distributing the proceeds. In the course of modernization of insolvency law and harmonization of European restructuring frameworks, new types of proceedings have been added which have as objective, if possible, to restructure the debtor's operations to ensure its ongoing viability.

Upon the opening of insolvency proceedings, creditors are prohibited from taking individual enforcement actions against the debtor.

Insolvency proceedings can be initiated either by the debtor (voluntary insolvency) or by the creditors (involuntary

insolvency). The main condition for the opening of insolvency proceedings is a situation in which the debtor is either overindebted (liabilities exceed assets) or in a state of illiquidity (unable to meet its payment obligations as they become due).

After the debtor or a creditor file for insolvency of the debtor, a preliminary administrator is appointed by the insolvency court to check whether sufficient assets are available to cover the cost of the proceedings. If these costs are deemed to be covered, the regular proceedings commence and the court appoints an insolvency administrator to manage them, to represent the debtor, and ensure the orderly distribution at the end of the proceedings.

In cases where restructuring is possible, an insolvency plan may be developed. The plan outlines the steps for restructuring the company's operations, debts, and financial obligations. Creditors' approval is typically required for the plan to be implemented.

Upon commencement of the regular insolvency proceedings, the creditors must lodge their claims within a given deadline and may take back any goods delivered under retention of title (ROT).

The average duration of German insolvency proceedings is about four to eight years, while the creditors receive on average a distribution of 6.1 % of the initial claims at the end of the proceedings.

Retention of title in Germany

Retention of Title (RoT - Eigentumsvorbehalt) is the most important collateral for businesses in Germany. Debt recovery results can be improved and insolvency losses can be significantly reduced by using RoT clauses. German law knows different types of retention of title rights. The three most important ones are:

With a simple retention of title (einfacher Eigentumsvorbehalt), the goods supplied remain the seller's property until payment of the full purchase price. Thus, in case of insolvency, the seller can request from the insolvency administrator to return the goods. In practice, the administrator will mostly not return these goods but pay for them as these goods will be needed for the insolvent debtor company's going concern. However, the simple RoT only works as long as the goods are in the warehouse and can be identified as unpaid.

The extended retention of title (erweiterter Eigentumsvorbehalt) says that all goods - either paid or unpaid - remain the seller's property until the buyer will have paid all outstanding invoices resulting from the parties' business relationship. Thus, the seller can request from insolvency administrator to return the goods remaining in the debtor's warehouse, without having to prove, which goods have been paid or not.

In turn, the prolonged retention of title (verlängerter Eigentumsvorbehalt) will stipulate that the seller remains owner of the goods but allows the buyer to sell the goods to the final buyer, under the condition that the buyer prior assigns the purchase price resulting from the resale as a collateral to the seller. Consequently, in case of insolvency of the first buyer, the seller could request the final buyer for payment of the purchase price. In practice, the insolvency administrator will collect the proceeds from the resale directly from the end-buyers, separate the funds on trusted accounts, pay the suppliers having RoT rights and keep the debtor company's margin for the insolvency estate.

To be valid the RoT must be agreed between the two parties before the goods are delivered. Confirmation and acceptance of the RoT through email communication may normally be sufficient. RoT clauses may also be used in general terms and

conditions (GTC) of the seller. The seller's GTC should be sent to the buyer together with the order confirmation at the very latest.

However, it is highly recommended to include RoT clauses expressly in a detailed sales contract or framework contract between the parties. This is of importance as the buyer may use contradictory general purchase conditions, which under German law might lead to the invalidity of the RoT.

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This debt collection guide is provided for general informational purposes only. Any information contained herein should not be construed as legal advice and is not intended to be a substitute for legal counsel on any subject matter.

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