German Federal Court on "Unfairness" under § 142 InsO – A Broad Playing Field After All

Towards the end of last year, Germany's Federal Court of Justice (BGH) issued its first interpretation of the term "unfairness" (Unlauterkeit) as introduced into § 142 of the Insolvency Code (InsO) during the 2017 reform. This decision marks a significant development and provides a timely opportunity to explore its implications for the so-called "cash transaction exemption" within German insolvency law.

Background

Even where a legal act carried out by the debtor is in principle contestable under §§ 129 ff. InsO—such as in cases involving failed restructuring attempts (see e.g. here)—the "cash transaction exemption" under § 142 InsO may apply. According to this provision, a debtor's act (or "performance") is generally not contestable if they receive an equivalent counter-performance directly into their estate. This "directness" is satisfied where the exchange occurs in close temporal proximity, in line with the nature of the exchanged services and commercial practice.

Before the 2017 reform of avoidance law, acts that were subject to intentional fraudulent conveyance under § 133 InsO were excluded from the scope of this exemption (see the previous version of § 142 InsO here). The reform took on elements from existing case law, which had developed the concept of "quasi-cash transactions" to allow for exceptions in extreme cases where § 133 InsO would otherwise apply too harshly.

Under the revised § 142(1) InsO, a transaction that would ordinarily fall under the cash transaction exemption remains contestable under § 133 InsO only if the other party (i.e. the creditor or defendant in the avoidance claim) "was aware that the debtor was acting unfairly." However, the statutory materials offer no guidance as to what constitutes "unfairness."

The Decision

In the case before the BGH, the insolvency administrator sought to challenge payments made to one of three limited partners of a service company. From the outset, the debtor had been operating at a loss, with due liabilities consistently exceeding available liquidity. Services rendered were invoiced and paid in the month following delivery.

Although the transactions satisfied the criteria of a cash transaction under § 142 InsO (i.e. immediate and equivalent exchange), the administrator argued that the ongoing unprofitable operation of the business constituted unfair conduct, thereby making the payments contestable.
The BGH first reviewed various academic interpretations of the term "unfairness" (see para. 19 onwards), before setting out its own definition (from para. 23). According to the Court, a debtor acts unfairly in the context of a cash transaction if the transaction serves less as an ordinary exchange and more as a deliberate act to harm other creditors.
This may apply, the Court continued (from para. 27), in three specific types of cases:

(1) Unfairness due to unnecessary transactions

A cash transaction may be unfair if it is not necessary for the continuation of the business. This could involve, for example, spending on luxury goods or disposing of essential operational assets where the debtor intends to remove the equivalent value from the estate—thereby intentionally harming the collective interests of creditors.

(2) Preferential treatment of individual creditors

Unfairness may also arise where a debtor's motivation is not to fulfil an existing contractual obligation but to deliberately favour one creditor over others. This might include making a payment specifically to prevent the creditor from filing for insolvency. The same principle can apply if the debtor initiates such a transaction in anticipation of an unavoidable insolvency filing. The Court also considers it potentially unfair if a transaction funds an evidently futile restructuring attempt.

(3) Transactions with related parties

Unfair conduct may further be presumed when the debtor enters into cash transactions with related parties (as defined under § 138 InsO) and treats them more favourably than other creditors. In such cases, the surrounding circumstances may indicate that the transaction was driven primarily by personal or corporate ties rather than standard business considerations. Similarly, unfairness may exist where key remaining assets are transferred selectively to favoured creditors. This also applies within corporate groups, if cash transactions are used to divert residual value from the debtor to a related company.

Commentary

The BGH's detailed reasoning provides the first solid post-reform guidance on how to apply the cash transaction exemption in practice—something to be welcomed. Particularly valuable is the Court's express rejection of the notion that an unprofitable business alone constitutes unfair conduct.

The first category, involving asset squandering, is especially persuasive: in such cases, both debtor and creditor may already be on the verge of committing bankruptcy offences under §§ 283 ff. of the German Criminal Code. Likewise, payments made to silence creditors threatening to file for insolvency are straightforward examples of unfair preferential treatment.

However, the classification of failed restructuring efforts as inherently suspect is more problematic. Especially in light of the BGH's own decision in the QCells case (BGH, judgment of 3 March 2022 – IX ZR 78/20), handed down under the previous version of § 142 InsO, this approach risks undermining the intent of the reform. Given the BGH's increasingly nuanced case law on restructuring attempts (see here), there is concern that the reform's protective purpose may be diluted in this context.

As for the third group—related-party transactions—the Court's stricter scrutiny appears justified. Yet in the case of last-minute asset transfers or intra-group exchanges, further criteria would have been welcome to clearly distinguish legitimate transactions from unfair conduct. After all, even in these scenarios, the statutory requirement remains that the debtor must receive an equivalent counter-performance.

Practical Note

The BGH's newly articulated criteria for identifying unfairness are, in many respects, sensible and workable. Anyone who, during a financial crisis, enables the purchase of luxury goods, applies pressure to gain an advantage over the general body of creditors, or leverages close ties to the debtor for preferential treatment should not be able to benefit from the cash transaction exemption. These case types are relatively easy to explain in practice. The challenge, however, lies in defining the boundaries of unfairness in the context of attempted restructurings—where nuance and care are essential.