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Successful Legal Claim Management in Germany

The legal process and its preconditions

Nearly every company and every entrepreneur faces the issue every now and then or indeed even frequently: When customers do not pay for the delivery of services or goods on time the supplier unintentionally becomes a lender. Massive default in payment can cause severe problems in business and in the worst cases it can lead to insolvency. Even under the consideration of a good customer relationship no one can afford to ignore this issue. The following description is meant to give a brief overview of efficient legal claim management in Germany.

I. Prerequisites for successful legal claim management

1. Know your customer – maintenance of master data

Before closing contracts it should be routine to gather some information up front: Who is the potential customer? Who are the persons in charge? Under which kind of legal status is the company run? What is known about their business conduct? Is information available about their financial status? What about liability and so on. Much information can be gathered simply through internet research.

In Germany there are basically two general types of companies. Companies with limited liability such as “GmbH”, “Ltd.”, “u. G.”, “GmbH & Co. KG”, “AG” and companies with unlimited liability of their shareholders such as “GbR”, “OHG” and sole proprietorships.

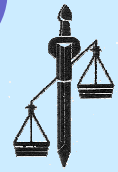
Not merely for the sake of being aware of the liability is it essential to know the full and correct name, legal status and address of the potential customer but also for the purpose of avoiding any misunderstandings in further along during business relationship. If the contract, the order, the bill of lading or the invoice do not name the full and correct company name including legal status such omissions or errors might cause severe difficulties within the legal claim management process. “The invoice is not addressed to our company” or “We never received your invoice” are only the minor consequences as result of incomplete master data. Even worse might be e. g. the credits insurance’s denial of compensation if the wrong company was insured unintentionally, such as the affiliate with same name under the same address but only under other legal status instead of the actual contractual partner.

2. In-house-workflows

To follow up the average days outstanding it is necessary to check on the payment history of the customers constantly. Establishing clearly defined routines in case customers fail to pay on time is strongly advisable. Of course these routines might consider the customer relationship in each case but nonetheless after a certain period of time - which should not be too long - the customer needs to be addressed and reminded of accounts receivables.

In case the outstanding claim is subject to credit insurance it is important to observe the obligations under the insurance contract such as the obligation to report the exceeding of payment terms.

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3. Notice of default

For the further legal process it is vital to give the debtor a notice of default. For the purpose of evidence, this should be done in writing.

Generally, invoices are payable on receipt unless they contain a due date of payment - if so they are payable on the due date. According to German law the debtor is legally not in default only because the due date has expired. A demand note is required to legally set the debtor in default. Only if the debtor is not a consumer are they automatically in default 30 days after receipt and due date of the invoice. If you take for granted that the debtor is in default 30 days after receipt and due date of the invoice you might face the risk of not being able to prove whether the debtor received the invoice and when they did so. This makes it very difficult to clearly define the point of time from when the debtor legally went into default. Therefore it is strongly recommended to send a reminder shortly after the due date has expired. As the case may be a phone call is useful to verify that the reminder was actually received and to request explanations for non payment.

As soon as the debtor is legally in default they have to compensate the creditor for default interest and all costs occurring due to the default payment. According to German law the rate of interest for claims for payment is eight percentage points above the basic rate of interest as far as entrepreneurs are concerned. In case consumers are involved the interest rate amounts to five percentage points above basic rate of interest. Lawyer's fees must also be compensated by the debtor.

4. General terms and conditions

In many cases companies use general terms and conditions to stipulate certain issues such as payment terms, retention of title, place of jurisdiction, applicable law, etc. Such terms and conditions only apply if and when they are part of the contract. Therefore both parties have to agree on the terms and conditions with conclusion of the contract.

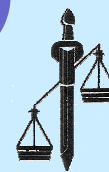
General terms and conditions that are e. g. upon first sighting made available on the back of the invoice never apply. The other party must be given notice that general terms and conditions shall be part of the contract. They must be given the opportunity to view the stipulations and finally they must agree on the general terms and conditions which is in most cases done conclusive by closing the contract. In any case, having signed the general terms and conditions and ensuring that they apply is advisable.

Provided you agreed on general terms and conditions of your contractual partner make sure to check carefully if they contain stipulations regarding the due date of claims before initiating your in-house-dunning procedure.

German law provides several regulations regarding the legitimacy of general terms and conditions. In case there are doubts concerning your or your contractual partner's general terms and conditions it is strongly advisable to contact your lawyer. If general terms and conditions are legally ineffectual the rules and regulations of the German Civil Code apply instead (given that German law is applicable).



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5. Limitation of actions

The chances to collect outstanding debts are much higher when proceedings are taken at an early stage and when they are consequently followed up. The willingness to pay outstanding debts decreases rapidly as time goes by. Over time the risk that the debtor is out of business or gets liquidated rises. Furthermore documents might get lost, witnesses become more and more unreliable and so on. Therefore it is strongly recommended to take action as soon as possible and very consequently: "Follow through on your ultimatum".

According to German law claims expire in general after three years at the end of a year. In the last months of each year make sure that no claims expire.

6. Payment plans

Frequently the reason for non-payment is simply lack of liquidity. Debtors try to avoid payments as long as possible and eventually ask to pay by instalments. Generally this is an acceptable option for both parties. The creditor has a chance to collect all outstanding debts and the debtor remains capable of conducting business. A few points should be considered when closing a payment plan. The agreement should contain an acknowledgement of debt to waive all potential objections. It is furthermore essential to agree on an acceleration clause to make sure that the outstanding amount can be claimed in case the debtor failed to pay an instalment. Of course the payment plan should also consider all accrued costs and interest.

II. Out of court proceedings

As soon as there is no result from the in-house collection the case should be submitted to a law firm specialized in debt collection or a debt collection agency. Sometimes the debtor does not react at all. If the debtor still exists it is necessary to raise pressure to cause a reaction. Usually a letter of a third party is noticed, especially of a law firm. In other cases the debtor objects the claim. In these cases the law firm or the debt collection agency takes care of the case and handles the objections, collects the outstanding amount or is able to find a suitable agreement. At the latest, debt collection agencies generally work together with law firms as soon as judicial proceedings are necessary.

It is most essential that the law firm or debt collection agency works quickly, consequently and transparent for their clients. It is more and more state of the art providing web based information systems including statistical evaluation to keep clients updated.

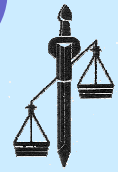
III. Court proceedings

1. Judicial dunning proceedings

A proven way to gather outstanding debts in Germany is the judicial dunning procedure. This is a simplified court proceeding meant for undisputed claims to obtain a title quickly. Communication with courts is done electronically so that the whole process usually takes only a few weeks. Court fees amount to merely 1/6 of regular court proceedings.

Especially when the debtor does not react at all judicial dunning procedures are an effective way to raise pressure. In case the debtor does neither object the court order nor the enforcement order law enforcement can be conducted immediately. Obtaining a title throughout judicial dunning procedure is also an effective way to secure a debt or an amicably solution – such as a payment plan.

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In case debt collection agencies conduct the judicial dunning procedure themselves costs are reimbursable up to 25.00 EUR only whereas the lawyer's fee is fully reimbursable. Therefore usually collection agencies entrust their lawyers with conducting the judicial dunning procedure because otherwise additional costs have to be borne by the creditor.

Judicial dunning proceedings are generally not suitable if and when the debtor clearly refused to pay e. g. because of alleged counterclaims. In these cases it is very likely that the debtor objects the court order so that only time is wasted. If the debtor objects the court order or the enforcement order regular court proceedings follow.

Whenever the parties agreed on arbitration conducting of regular court proceedings is excluded. This refers also to judicial dunning proceedings.

2. Court proceedings

Litigation in Germany is comparably quick. According to the statistical evaluation of the Berlin Senate Administration of Justice the average duration of court proceedings in front of Local Courts in 2009 were 4.1 months and in front of Regional Courts 9.4 months. In front of Courts of Appeal the average duration of proceedings in 2009 was 6.8 months respectively 11.4 months in front of Higher Regional Court.

Costs for court proceedings are dependant on the amount in dispute. Generally the losing party has to bear all costs arising from the law suit including the legal fees of the opposing party according to German Lawyers Fee Act. In case one party is not able to succeed to the full extent the costs are proportionally divided between the parties.

In front of Regional Courts, Higher Regional Courts and in front of Federal High Court of Justice a Lawyer is required to appear in court. Except for some cases in front of Local Courts a Lawyer is generally not required. Nonetheless usually both parties refer to lawyers to exercise their rights in the best possible way.

3. Law enforcement

As soon as a title is obtained there are several ways to enforce it. The bailiff can be entrusted to seize assets as well as bank accounts. The latter is very effective even in the context of provisional garnishment. The debtor can be forced to reveal all assets and liabilities by statutory declaration to allow seizure and realization.

IV. Insolvencies

Unfortunately insolvencies are on the rise. As soon as the debtor filed for insolvency it becomes much more difficult to secure one's rights. According to German law the companies with limited liability have to file for insolvency as soon as they are unable to pay or if and when they are overindebted. Not doing so can be subject to criminal offence regarding the responsible person. Creditors can also file for insolvency on behalf of the debtor.

As soon as preliminary insolvency proceedings are opened by the respective court in charge the debtor is generally not allowed to pay any outstanding claims anymore. Under certain conditions business can still be conducted but it is strongly advisable to contact a lawyer to make sure the supply of services and goods will be paid. Usually the responsible contact person on the debtor's side is the preliminary insolvency administrator. All goods should be delivered only under retention of title. In case the debtor still possesses goods retention of title should be claimed (given that the parties had previously agreed on it).

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In the case of the insolvent company still having enough assets, the insolvency proceedings are opened otherwise the company is liquidated. In case there is no retention of title or the goods were already sold the creditor can only lodge the claim. Make sure to follow the terms set by the administrator to avoid additional costs and trouble.

Usually insolvency proceedings in Germany take several years before a result becomes apparent. In most cases the quota does not exceed three to five percent.

V. Conclusion

Recovery of outstanding debts in Germany is generally promising due to a well developed and reliable judicial system. German law provides all necessary tools to collect outstanding debts and to enforce titles. Nonetheless it is vital that creditors think of an effective contractual framework along with in-house workflows for efficient claim management and for keeping and providing relevant data. Efficient legal claim management requires quick and consequent action before and after experts are entrusted to collect accounts receivables. Even in the case of the debtor filing bankruptcy, there is still a range of measures that can be taken to secure the creditor's rights.

From the Secretariat

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Fecma council meeting on 19th November 2010

The French Association AFDCC hosted the Fecma Council meeting in the autumn of 2010. They are celebrating these days their 40th Anniversary. On the evening before the meeting they invited the Fecma Council to visit their new premises. With a glass of Champagne and a very lovely dinner afterwards we joined them celebrating.

During the meeting some new representatives of the Fecma members were presented. The meeting was very lively. The two prospective members, Spain and Czech Republic were formalised as official members and the Council was informed that also in Switzerland a Credit Management Association is built up. The Hungarian Association, which was prospective member to was not attending the meeting. They did apply for the membership but this could not be formalised yet.

On the Guide on Credit Management we could announce that Chapter 5 and 6 are almost finished and will be published on the website soon.

The first 4 Chapters are published on the Fecma website (www.fecma.eu) and the subjects are:

1. Credit Policy
2. The Invoice
3. Risk Assessment
4. Minimum requirements.

The Fecma Council decided to built up a Group on LinkedIn to keep in touch with each other on the main topics on European Credit Management. If you want to join this group please follow the link: <http://www.linkedin.com/groups?mostPopular=&gid=3692473>.

In the first half of 2011 a visit to Brussels is planned to meet with some delegates of the European Commission who are involved with Finance, and Credit Management in special.