

European Court of Justice Rules on Applicable Law in Cross-Border Clawback Proceedings

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On April 16, 2015, the **European Court of Justice (“ECJ”)** provided guidance on the interpretation of Article 13 of the EC Regulation on Insolvency Proceedings (the “Regulation”) in the case **Lutz v Bäuerle – C-557/13**.

Pursuant to Article 4.2 of the Regulation, the general rule is that the law of the Member State where the insolvency proceedings are opened determines the rules and procedure for the opening of the proceedings, their conduct and their closure, in particular the rules relating to whether certain legal acts detrimental to all creditors can be voided. An exception to the rule is found in Article 13 of the Regulation, which states that the law of the Member State where the proceedings were opened will not apply when the person who benefited from the act detrimental to all creditors proves that (i) the act is subject to the law of another Member State and (ii) that law does not provide for any means to challenge the act.

ECZ Autohandel GmbH (“ECZ”) was a German car retailer, which established an Austrian branch. An individual, Mr. Lutz, ordered a car from the Austrian branch but the car was never delivered. Mr. Lutz obtained a judgment from an Austrian court for the amount of the purchase price and an attachment against 3 bank accounts in Austria. In August 2008, insolvency proceedings were opened in Germany for ECZ. The insolvency administrator, Ms. Bäuerle, initiated a lawsuit in the German court challenging the payment made from ECZ’s bank accounts in Austria to Mr. Lutz. However, Mr. Lutz argued that such payment could no longer be challenged by the administrator because Austrian law provides for a statute of limitation of one year for an action to void a transaction and that such period had already expired.

The German Court decided to suspend the proceedings and to refer questions regarding the interpretation of Article 13 to the ECJ because, unlike Austrian law, German law provides for a statute of limitation of three years for an action to set aside transactions and the administrator had started the proceeding within this time frame.

The ECJ ruled that: (i) Article 13 applies to a situation in which an insolvency administrator challenges a payment made before the opening of the insolvency proceedings, (ii) Article 13 includes

defense based on time limitation relating to actions to set aside transactions under the law governing the act challenged by the liquidator, and (iii) the relevant procedural requirements for the exercise of an action to set a transaction aside are to be determined in accordance with the law governing the act challenged by the liquidator.

The ECJ explained that the legitimate expectations of creditors and third parties before the opening of an insolvency proceeding in a Member State, other than the state where the insolvency proceeding is opened, have to be protected. Therefore, creditors and third parties have the right to use all defenses (whether substantive or procedural) available under the law governing the act subject to the challenge. Because the attachments being challenged had taken place in Austria before the opening of the German insolvency proceeding, the German court had to apply Austrian law when considering the challenge by the German liquidator. The Austrian time limit was an absolute defense to the challenge.

The ECJ further explained that acts, which take place after the opening of an insolvency proceeding, are not subject to the exception of Article 13, because creditors are then able to predict the effects on their legal relationship with the debtor. The ECJ clarified that, in a situation in which a creditor exercises after the opening of an insolvency proceeding a right *in rem* in accordance with Article 4 of the Regulation (such as an enforceable payment order) which has been established before the opening of the insolvency proceeding, this action will be subject to the exception of Article 13.

An insolvency administrator, who intends to challenge acts with a cross-border element, has to carefully evaluate the impact of foreign laws before seeking to void certain transactions. German insolvency administrators who, in the past, have relied on the period of three years to challenge certain acts should carefully consider the influence of foreign laws on avoidance actions to avoid the risk of personal liability.

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