Banking & Finance

Key Considerations for German Loan Financings

Germany is Europe's biggest economy and, in particular after Brexit, a key financial market within Europe and worldwide. Domestic financings in Germany are mainly governed by German law, whereas international financings involving German borrowers are (notwithstanding Brexit) still often governed by English law, although many are now governed by German law. Larger financings are mainly based on LMA-style documentation. Despite many similarities to English law, there are four key points to consider in relation to German law governed financings resulting from applicable German statutory law, as set out below. Further, lenders need to take into account applicable license requirements to conduct credit business in Germany.

1. (Invalid) Upfront Fees

According to the case law of the Federal Court of Justice, upfront fees (including underwriting and participation fees) based on lenders' general terms and conditions are generally unenforceable. However, there are mitigants customarily used in the market to agree these fees validly.

2. No Compound Interest

German statutory law prohibits automatic or a pre-agreed compounding of accrued interest. This is based on the principle that lenders may not charge interest on interest. The most common practical implications are in relation to payment in kind (PIK) and default interest, were governed by German law. However, there are mitigants customarily used in the market to achieve a similar outcome.

3. Mandatory Termination Right upon Change of Interest Rate

German law allows a borrower to terminate a German law governed floating interest rate loan at any time when the interest rate changes (i.e. when the base rate is adjusted at the start of a new interest period), without triggering any additional costs or fees (including make-whole payments). However, there are mitigants customarily used in the market to achieve a make-whole period extending beyond the first interest period for these types of loans.

4. Capital Maintenance Rules / Financial Assistance Restrictions

Capital maintenance rules under German law limit the ability of a German limited liability company (Gesellschaft mit beschränkter Haftung) ("GmbH") and a limited liability

WHITE & CASE

Andreas Lischka
andreas.lischka@
whitecase.com

Vanessa Schürmann
vanessa.schuermann@
whitecase.com

partnership with (only) a limited liability company as general partner ("GmbH & Co. KG") to provide guarantees and/or security to secure indebtedness owed by (a) their (direct or indirect) shareholders (so-called upstream security) or (b) subsidiaries of their (direct or indirect shareholders which are not subsidiaries of the relevant security provider (so-called cross-stream security). German law treats the provision of such upstream or cross-stream security in the same way as a dividend or other form of distribution. Therefore, upstream and cross-stream security is, generally, only permissible if and to the extent it does not affect the stated share capital and the non-distributable reserves (together, the protected capital) of the relevant security provider. The provision of upstream or cross-stream guarantees or security which affects the security provider's protected capital may result in personal liability of the security provider's managing directors. Therefore, subject to certain exemptions, guarantees and security interests provided by German GmbH's and GmbH's & Co. KG's are customarily subject to so-called limitation language to ensure that the enforcement of the relevant guarantee or security does not affect the security provider's protected capital.

German stock corporations (Aktiengesellschaften) ("AG") are subject to even stricter capital maintenance rules. In a nutshell, they usually only provide upstream and/or cross-stream security in very limited circumstances where legal exemptions apply.

Practice Area News

Restructurings. Due to a hike in interest rates and a slow-down in many businesses (some of which were only recovering from Covid related business effects), we see many borrowers requesting that their lenders waive financial covenant breaches and lenders considering whether or not to terminate and enforce the relevant loans. We have now also seen the first restructuring of 2023 and expect more to come in the next two years.

StaRUG. In 2021, Germany implemented a new pre-insolvency restructuring proceeding under the German Corporate Stabilisation and Restructuring Act ("**StaRUG**"). StaRUG enables debtors to restructure debt and processes on the basis of a restructuring plan with the consent of the majority of its creditor. We have already seen the first StaRUG cases and expect that this will be a major trend over the coming years.

(No) Negative Interest. The German Federal Court of Justice ruled that interest on floating rate loans (i.e., the sum of the floating rate and the applicable margin) may not become negative. Hence, lenders are not required to pay negative interest to borrowers, even where borrowers have not agreed to a zero floor. The ruling will, in light of increasing interest rates, become less relevant, but does provide answers to ongoing disputes and guidance for the future.

ESG Link. A growing number of German financings (including bonds) are linked to an environmental, social and governance framework (together "ESG"). Currently, ESG linked financings typically include interest rate adjustments dependent on ESG performance in relation to certain key performance indicators. Since ESG links are more and more relevant for the lenders' ability to invest into and to syndicate loans, we expect this trend to continue and ESG links to become market standard.

In the Firm

Top Tier Banking Practice

Our German Banking & Finance team is part of a #1 ranked global Banking Practice.

White & Case in Germany

- a full service, integrated legal offering, with focussed sector knowledge
- a leading TransAtlantic Firm with a truly global footprint
- a pre-eminent, long established German presence, which is part of a strong international network
- entrepreneurial, cutting edge and pioneering legal work
- high-quality, commercial and practical advice

WHITE & CASE

Germany
www.whitecase.com