
CHAMBERS GLOBAL PRACTICE GUIDES

Debt Finance 2024

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Germany: Law & Practice

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GERMANY



Law and Practice

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1. Market

1.1 Debt Finance Market Performance

In 2023, the German debt finance market faced several challenges. In particular, the increases in interest rates have pushed up borrowing costs and therefore constrained issuance activity. Reduced M&A activity and cautious underwriting by banks resulted in limited buyout financing opportunities. Where debt finance transactions have progressed, the bulk of activity has been propelled by refinancing deals. Private credit continued to be a significant source of funding in 2023, which led to certain banks starting their own private credit funds to remain competitive in all areas.

The volumes of non-performing loans (NPLs) fell by approximately 9% in 2022, as recovery from the COVID-19 crisis continued which also extended into 2023. However, against the backdrop of the Ukraine conflict, the tensions the European Banking Authority warned of the effects of geopolitical tensions. It pointed to data from Eurostat revealing that declared bankruptcy numbers had reached an all-time high at year-end.

Financing markets have also been impacted by distress in the German real estate sector. After a period of consolidation in German real estate, funded by loans and bonds issued at low rates, climbing debt servicing costs and corrections in property valuations have left real estate companies with high debt burdens and mushrooming financing costs. This has seen German real estate transactions fall to their lowest levels since 2014 on a 12-month rolling basis.

In Germany and Europe, the high yield markets had an increase in activity. The issuance of high yield bonds in Germany climbed from USD612

million in 2022 to USD6.5 billion in 2023. Issuers pivoted towards fixed-rate, high yield bonds over floating-rate syndicated loans in an unpredictable interest rate environment. But even though high yield bonds have offered more certainty on pricing, the double-digit rise in year-on-year issuance in 2023 must be placed in the context of exceptionally low levels of high yield issuance in 2022.

In 2021, Germany implemented a new pre-insolvency restructuring proceeding under the German Act on the Stabilisation and Restructuring Framework for Businesses (*Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen* (StaRUG)). StaRUG enables debtors to restructure debt and processes on the basis of a restructuring plan with the consent of the majority of its creditors. We have already seen the first StaRUG cases and expect that this will be a major trend over the coming years for distressed businesses or businesses needing to refinance in difficult market conditions.

After a challenging period for sponsor deal activity and limited access to new debt financing, the outlook for 2024 is improving. Expectations of interest rate stability are raising hopes that pricing and modelling capital structures will be easier and allow gaps in pricing expectations between buyers and sellers to narrow.

High levels of dry powder and unexcited assets will put structural pressure on managers to do deals, improving prospects for debt financing pipelines.

Private debt has gained market share and will remain a key part of the acquisition finance sources, but loan and bond markets have improved, providing sponsors with a wider set of debt financing options.

1.2 Market Players

The various market players differ in relation to their investment behaviour and willingness to take risks.

Banks are bound by the regulatory requirements of the banking system and operate their business based on a highly leveraged balance sheet with relatively low equity. They are therefore also more susceptible to crises. Banks therefore continue to be very focused on appropriate protections in the legal documentation and require various internal approvals including most notably compliance/sanctions/AML, credit and legal. Banks have advantages in corporate financings, where a working capital line is often sought, which is almost only possible in Germany with a banking license. Banks also still have lead roles in debt capital markets or other institutional debt financings for both corporates and sponsors because of their strong ability to book build.

Private debt lenders are bigger risk-takers due to fewer internal and regulatory restrictions and have more freedom in the individual structuring of the loan. The opportunities for private debt will be many and varied, and increasingly a premium will be attached to players who can provide “flexible capital”. The ability to deploy across the capital structure and across the life cycle of acquisitions, strategic expansion and dispositions or other forms of exit will be valued by sponsors as they seek creative solutions to new money financings, growth financings and/or the re-balancing of existing capital structures.

Private debt has emerged from the 2022-23 downcycle in credit market in a strong position, delivering yields on senior secured risk in the region of 10% and continuing to finance deals, although pricing has dropped in particular in Q2 2024 as the capital markets and institutional

debt markets strengthened. Investment banks have noted the success of the private debt model, and 2024 could see increasing numbers of banks move to imitate this model by launching and expanding their own private credit capabilities.

As a result, banks and debt funds are increasingly working together, which creates further advantages for the borrower. The presence of various market players means that a broader market spectrum can be covered and there are more bespoke options available. Especially in times of crisis/slow capital markets or in cases of lower creditworthiness, when banks tend to be more cautious, the variety of debt finance sources enables the borrower to reach a broader mass and secure its debt financing needs, which is why the importance of different market players should not be underestimated. Debt funds will therefore continue to grow in importance.

1.3 Geopolitical Considerations

Russia’s attack on the Ukraine in 2022 has a noticeable impact on the German market. This is primarily due to the sharp rise in energy prices and the high energy requirements of the German industry. Higher costs due to rising energy prices, coupled with weak exports and weak GDP growth, have depressed companies’ EBITDA figures. Added to this are higher borrowing costs, which have made securing new debt financing packages almost unaffordable for many companies.

In particular, the combination of the energy price problem resulting from the Russian-Ukraine war and the extraordinary government support measures due to the COVID-19 pandemic has led to an increase in corporate credit default rates. This also means that banks’ default risks are increasing and the ratio of NPLs is rising.

However, it should be emphasised positively that the NPL ratios in Germany are still overall at a low level.

The geopolitical conflict in October 2023 also led to turbulence on the financial markets. The Israel-Gaza conflict has added another geopolitical uncertainty factor that is influencing volatility on the financial markets. This was reflected in the falling share prices in the period immediately after the initial attack. In general, there are fears that internationally active financial groups could be forced to adapt their business models. Furthermore, the possibility of financial fragmentation cannot be ruled out as international investors withdraw from individual countries. The opportunities for risk diversification and optimal capital allocation are expected to decrease accordingly.

The change in the central banks' interest rate policy also had less of an impact than expected. German banks were able to increase their net interest income in the course of the interest rate turnaround, which is probably due to the unexpectedly low financing costs. Nevertheless, there are still risks for the German financial system, as an accelerated interest rate adjustment for bank deposits and therefore a decrease in net interest income is to be expected.

2. Types of Transactions

2.1 Debt Finance Transactions

In Germany, the landscape of debt finance transactions mirrors the diversity seen in other developed financial markets, with several types of transactions being particularly prevalent due to the country's strong industrial base, significant number of medium-sized companies, and active

real estate market. However, real estate financing fell significantly last year by 48%.

Acquisition Finance

Over the last year, several factors have had a discernible adverse impact on the German M&A market. These include a marked rise in interest rates, diminished consumer confidence, and international political events leading to armed conflicts and sanctions. These factors primarily contributed to a reduction in larger and international transactions. Conversely, deal activity within smaller and mid-cap transactions in the German and DACH region remained relatively stable. Furthermore, there has been a continuing and intensifying trend among market participants to become increasingly selective, with a pronounced emphasis on transactions in technology-driven sectors and those with a focus on Environmental, Social, and Governance (ESG) criteria.

Asset-Backed Finance

ABF is increasingly attracting interest from investors seeking to explore opportunities in private credit investments, while simultaneously diversifying their investment portfolios. This asset class is comprehensive, spanning a diverse array of financial instruments, from consumer loans and mortgages to agreements involving music royalties.

Asset-Backed Securities

Historically, in Germany, ABS have been mainly used by car manufacturers for their leasing and financing business. Recently, they have also become an option for small and medium sized enterprises. Last year, for example, a photovoltaic start-up set up the first private asset-backed securitisation for solar systems.

Project Finance

Project finance is widely utilised in Germany for various projects, including renewable energy, transportation, and real estate development. In addition, Germany's commitment to renewable energy and infrastructure development has made project finance a significant area of activity. Financing for wind farms, solar energy projects and public infrastructure projects are notable examples, often involving complex arrangements with multiple stakeholders.

3. Structure

3.1 Debt Finance Transaction Structure

Common Forms of Loans

Bank loans are in the first instance categorised according to:

- the purpose of the financing (acquisition or investment financing, real estate financing, working capital loans);
- the term (short, medium, or long-term financing);
- creditworthiness of the borrower;
- whether or not collateral is required and the type of collateral to be provided;
- guarantor coverage threshold to the extent guaranteed by subsidiaries of the borrower/parent company;
- number of lenders;
- covenant lite/loose or other types of financial covenants; and
- bond style versus loan style restrictive covenants.

We usually see term loans, revolving credit facilities and guarantee/letter of credit facilities, as a bridge or long-term financing, structured as a bilateral loan agreement or club/syndicated facilities with banks and private credit lenders

or, when the market is strong, with institutional lenders.

Advantages and Disadvantages of Syndication Loans

Compared to a bilateral loan, a syndicated loan regularly carries much larger loan volumes, as the default risk from the respective commitment is spread across several banks.

The advantages for the arranger include in particular:

- the management of the credit risk and the loan portfolio;
- the increase in profitability which they can obtain through
 - (a) the fees received for the arrangement; and
 - (b) any leverage effects of the regulated capital to be used;
- the deepening of the customer relationship with the associated possibility of follow-up transactions with the borrower (eg, price and interest rate hedging transactions, capital market transactions).

At the same time, managing a syndicated loan as an arranger leads to an enhanced reputation in relation to competitors and (potential) customers.

The advantages for the banks involved as lenders basically correspond to those of the arrangers, with the obvious difference that they can only achieve leverage effects to a much lesser extent and, as pure lenders, only participate to a lesser extent in the publicity of the transaction.

For the borrower, in addition to the above-mentioned stabilising effect of syndicate discipline, the syndicated loan also has the advantage that

the borrower can enhance its market reputation with a view to future capital markets eligibility.

4. Documentation

4.1 Transaction Documentation

In Germany, a debt finance transaction for which potential lenders have been approached begins with the negotiation of a term sheet. This non-binding document should set out the essential key terms. It is a useful tool to document the commercial terms negotiations that have begun. Even if it is not binding, it serves as a starting point for future in-depth negotiations and long-form documentation. Despite the non-binding effects, certain pre-contractual obligations including confidentiality undertakings, appointments of lead banks with certain roles and titles and indemnity obligations should be considered upfront.

The main documents (SFA/ICA) in Germany are mainly based on LMA standards especially where there is an international or syndicate angle and where large volumes are involved. Comparable organisations from Germany are the Deutsche Kreditmarkt-Standards e.V. or various banking associations but these forms of documentation are typically only seen in very domestic financings or bilateral arrangements with smaller volumes.

4.2 Impact of Types of Investors

The terms of a bank loan facility are significantly influenced by the profile of its investors, reflecting their varied risk tolerances, investment criteria and return requirements. Banks tend to offer the lowest pricing but tend to prefer shorter maturities and also require the most covenants and other legal protections. Institutional investors can get quite close to bank pricing in a strong

market, typically go for medium to long-term maturities ranging between five and seven years and can get comfortable with lighter covenants and other legal protections for the right credit in a strong market. Private credit lenders are a bit of a mixed bag but tend to be more expensive than banks or institutional investors in a strong market, prefer medium to long-term maturities between five and seven years like institutional investors but often require call protection as part of their higher minimum return model and most offer a middle ground as regards covenants and other legal protections.

4.3 Jurisdiction-Specific Terms

The main German-specific terms that need to be included in cross-border loan documentation relate to capital maintenance rules, equitable subordination and interest capitalisation.

Limitation Language

The granting of cross-stream or upstream guarantees or security by certain types of German legal entities is subject to certain provisions of German law known as German capital maintenance and/or liquidity maintenance rules to ensure that the amount of the German entity's net assets does not fall below the amount of its stated share capital. A violation of these rules could result in personal liability of the German legal entity's management and is therefore dealt with by including limitation language in the relevant legal deal documentation.

Pursuant to such "limitation language," the beneficiaries of the guarantees and security contractually agree to only enforce the guarantees and security against the German legal entity if and to the extent that such enforcement does not result in the relevant legal entity's net assets falling below, or increasing an existing shortfall of, its stated share capital.

Equitable Subordination

Under German law, shareholders are subordinated to third party creditors. For this purpose, the shareholder threshold is relatively low around 10%. In addition, there is a risk under German law for a syndicate of creditors that all of them would be subordinated to other third-party creditors of a German borrower if even only one member of the syndicate of creditors is a shareholder of the borrower within the meaning of the relevant German law provisions. In addition, the collateral securing the facilities might not be enforceable. This concept is known in the German legal finance market as cross-contamination. Therefore, it is important to include disenfranchisement and other protective provisions to the extent that a creditor in the syndicate ends up being a shareholder to avoid cross-contamination into the other creditors in the syndicate who are not shareholders of the borrower. The disenfranchisement provisions have not been court tested so far, but are expected to hold up in court if properly drafted in way that passes the German jurisprudence blue pencil test.

Capitalisation of Interest

Under German law, an agreement made in advance that interest will be capitalised is void. However, an agreement on the capitalisation of interest concluded after the due date of the interest has passed is permissible.

Notwithstanding the above-mentioned legal prohibition, there are four statutory exceptions to the admissibility of capitalisation of interest but they do not generally apply to the ordinary course of business of corporate lending.

5. Guarantees and Security

5.1 Guarantee and Security Packages

Types of Security:

Market practice in the upper mid- to top-tier space is to have very little to no hard asset security, being limited to share pledges, key intra-group receivables and material bank accounts. A more comprehensive security package consists of:

- bank account pledge;
- global assignment agreement;
- share pledge agreement,;
- subordination agreement with respect to any shareholder loans, although this is most often dealt with in the intercreditor agreement;
- security over moveable and immoveable assets;
- IP pledge; and
- land charges.

Things to consider regarding when it comes to guarantees and security:

- Personal credit support (guarantees): The applicable law for personal credit support, such as guarantees, can be freely agreed upon. Often, these agreements are already included in the facilities agreement. However, it's important to note that on enforcement, a foreign judgment may be required, depending on the guarantor's location.
- Non-personal credit support: For non-personal credit support, the law of the country where the item is located should be applied.
- Share Pledge: If the pledge of shares is envisaged, an appropriate structure should be chosen. In particular in relation to perfection and enforcement, there may be considerable differences depending on the jurisdiction of the company whose shares will be pledged.

Formalities and Perfection Requirements

Certain formalities must be observed for certain types of security.

For a bank account pledge, the third-party debtor must be notified in order for the pledge to be legally effective. To avoid triggering new hardening periods, such notifications should be sent either together with closing or shortly after signing the relevant security documents. An acknowledgement from the respective account bank is not required to be legally effective but is helpful for the practical administration of the bank account and security.

The notification requirement applies mutatis mutandis for any share pledge agreements. However, in many cases the notification requirement is fulfilled by the pledged company signing the share pledge agreement. In addition, certain share pledges (in particular over a private limited liability company (GmbH)) are required to be notarised.

Such notification is not required for an assignment to be legally effective. However, in the absence of such notification, the new creditor must accept payments made by the debtor to the previous creditor after the assignment as well as any legal transaction carried out between the debtor and the previous creditor after the assignment in respect of the claim, unless and until the debtor becomes aware of the respective assignment. Market practice is to provide notices of the assignment to the debtor except where the debtor is a customer or other trade debtor in which case notice is generally agreed to be provided upon the occurrence of certain defaults.

Perfection of a land charge requires notarisation and registration in the land register. Registration

can take up to a year and is therefore generally a post-closing formality. To provide certainty regarding effectiveness, usually a notary confirmation is issued stating that the application will be entered as first priority.

5.2 Key Considerations for Security and Guarantees

Agent and Trust Concept

Where a security agent is appointed, the security agent is holding the German accessory and non-accessory security as a trustee for the lender(s) – the accessory security (such as account pledges and share pledges) is held on the basis of a parallel debt, which is a separate and individual claim of the security agent and mirrors the aggregate claims of the lenders. The German accessory security, however, usually also secures the lenders directly, as the lenders can become a party to the German accessory security documents.

Although the security agent becomes the legal owner of the non-accessory collateral, the lender(s) remain(s) the beneficiary/ies. As the German accessory and non-accessory collateral is held on the basis of a German security trust it does not become part of the security agent's insolvency estate and is therefore protected from other creditors of the security agent, so that in the event of insolvency of the security agent, the collateral is separate and thus protected from the creditors of the security agent.

Parallel Debt

Under German law, certain security interests, such as pledges, are strictly accessory and are therefore dependent on the secured claims and require the security holder and the creditor of the secured claim to be identical. The accessory security interests will also be granted to the Security Agent. However, unlike the lend-

er, the Security Agent is not a creditor of the loan. Hence, such pledges will also secure a so called “parallel debt” obligation created under the facilities agreement or intercreditor agreement in favour of the Security Agent. This way, the accessory security interests are also granted to the Security Agent. The parallel debt is in the same amount and payable at the same time as the obligations of the borrower and the guarantors under the loan and the guarantees and any payment with respect to the obligations will discharge the corresponding parallel debt and any payment with respect to the parallel debt will discharge the corresponding obligations of the borrower or the guarantors. Although the Security Agent has a claim against the borrower and the guarantors in the full nominal amount of the loan due to the parallel debt, the legal concept of creating parallel debt relationships has not yet been tested in front of a German court. Therefore, there is no 100% certainty that such concept will be recognised by German courts, so the ability of the Security Agent to enforce the collateral may be restricted. However, using the parallel debt construct is accepted by all the large players in this area in the German finance legal market.

Restriction on Upstream and Cross-Stream Guarantees and Security

The right to enforce any German law governed guarantee under the facilities agreement or any security granted under a security document is, to the extent that it is upstream or cross-stream security by a German obligor which is a limited liability company (GmbH) or a GmbH & Co. KG, usually contractually limited in order to protect that German obligor’s management from personal liability. This restriction is created by limitation language, which protects the stated share capital of the GmbH (see 4.3 **Jurisdiction-Specific Terms**). Under certain circumstances, such

contractual limitation can lead to a complete unenforceability of the guarantees and security.

Financial Assistance

With respect to any company incorporated as a stock corporation (Aktiengesellschaft), any legal transaction consisting of the payment of, the granting of a loan or the provision of security by the stock corporation to some other party for purposes of purchasing shares of stock in this stock corporation is null and void. This does not apply to any limited liability company (GmbH) and financial assistance of such a company is generally permitted. However, a limited liability company should still take into account other corporate provisions that could be violated in the context of financial assistance. In particular, financial assistance can easily lead to a breach of rules regarding capital contributions and capital maintenance (as described above).

6. Intercreditor Issues

6.1 Role of Intercreditor Arrangements

In Germany, intercreditor arrangements play a crucial role in structuring the complex relationships between different creditors in debt financing. These arrangements are particularly important in transactions involving multiple layers of debt, or when there are different classes of creditors with varying security interests. The purpose of intercreditor agreements is to clearly define the rights, priorities, and remedies of each class of creditors in relation to one another, especially in scenarios of default, insolvency, or enforcement actions.

The following are key aspects of intercreditor arrangements in debt financings in Germany:

- Subordination: Certain creditors rank contractually behind other creditors with their claims under the loan and security agreements.
- Amendments: The subordinated creditors may not amend their financing agreements with the borrower to the detriment of the senior creditors.
- Restriction of payments: The subordinated creditors declare that they agree that their claims will not be satisfied until the claims of the senior lenders have been satisfied in full.
- Security: Additional security may only be provided to subordinated creditors if the same security is also provided to senior creditors (at least with contractual priority (*schuldrechtlich*)).
- Suspension of rights of subordinated creditors: Certain contractual rights of the subordinated creditors are restricted until all claims of the senior creditors have been satisfied in full.
- Insolvency: Granting of special rights to senior creditors and creating obligations on subordinated creditors in the event of the insolvency of a borrower or guarantor.
- Turnover of payments: Obligation on subordinated creditors to turnover liquidation proceeds or other payments received contrary to the contractual order or priority.
- Sole power of enforcement of the security agent: The security provided to creditors must be enforced exclusively by the security agent.
- Use of proceeds by the security agent: Payments and benefits to be distributed to the security agent as well as proceeds from the realisation of security are distributed by the security agent according to a certain order of priority.

6.2 Contractual v Legal Subordination

Legal Subordination

Mandatory legal subordination only applies in the event of insolvency. In order to secure the liability estate already before becoming insolvent the outflow of the liable capital can be streamlined by structuring a financing either with a contractual or structural subordination.

Contractual Subordination

In situations where two lenders are equally ranked at law, the better position of one lender over the other is determined by the term of its loan. Usually, a senior loan provides for a shorter term than subordinated loans in order to become due before the subordinated loan, so it can be fully satisfied, and any remaining proceeds can be applied to the later maturing loan. However, the loans may fall due at the same time if the conditions for a mandatory prepayment under both loan agreements are triggered. Hence, in an intercreditor agreement, a lender may grant another lender prior satisfaction of claims, regardless of the claim's maturity. In this case, the intercreditor agreement prohibits the early repayment of the subordinated loan until the senior loan has been fully satisfied. Therefore, the amounts designated for mandatory prepayment may not be used to repay the subordinated loans until all senior loans have been repaid in full.

Structural Subordination

Structural subordination can be created by granting loans at various levels within a group.

In order to increase the prospects of certain creditors (eg, the senior banks), other creditors can be structurally subordinated. This can be done with the subordinated lenders providing loans to a HoldCo above the OpCo, which on-lends the funds to the operating company as

equity or subordinated shareholder loans. The senior lender on the other hand will directly lend to the OpCo. Thus, such senior lender has direct claims against the OpCo. The structurally subordinated lenders, that lend to the HoldCo are one step further away from the cash flow of the OpCo, which is distributed by the OpCo in the form of dividends or repayments of shareholder loans to the HoldCo only after satisfying the OpCo's own lenders and other creditors. The further away a creditor is from the cash flow of the operating companies, the more it is structural subordinated.

On the other hand, structural subordination of a lender of the HoldCo towards a lender of OpCo can be eliminated if the OpCo enters into some sort of joint liability for the liabilities of the OpCo towards their respective lender, eg, by acknowledgement of debt (*Schuldanerkenntnis*), guarantee or by providing security over its assets for the OpCo's liabilities towards its respective lenders. A lender of the HoldCo becomes a direct creditor of the OpCo through the acknowledgement of debt by the OpCo or by the OpCo providing a guarantee for the HoldCo debt. By the OpCo providing security in rem in relation to the HoldCo debt only, the lender of the HoldCo may even acquire a senior position vis-à-vis a potentially unsecured lender of the OpCo in the event of OpCo's insolvency.

Insolvency

Insolvency law provides for certain ranking of creditors, inter alia, as follows:

- secured creditors;
- unsecured creditors;
- inter company-creditors; and
- equity.

The insolvency administrator is not bound by the ranking between the lenders as agreed in the intercreditor agreement or facilities agreement (see above "contractual subordination"). The insolvency law, however, does not differentiate between a senior and subordinated lender, that is only contractual subordinated. Hence, the insolvency administrator will treat a senior and a contractual subordinated lender generally equally and will satisfy the claims of all creditors in the amount of the insolvency quota. Between them and as set out in the intercreditor agreement, however, the subordinated lender is obliged to turnover the payments received from the insolvency administrator to the senior lenders.

7. Enforcement

7.1 Process for Enforcement of Security

The enforcement differs according to the security to be enforced. The most common realisation options in foreclosure enforcement are:

- forced auction (*Zwangsversteigerung*),
- a receivership (*Zwangsverwaltung*),
- transfer for collection (*Einziehung*),
- sale at public auction (*öffentliche Versteigerung*), and
- sale by private agreement (*Freihändiger Verkauf*).

Land Charge

The forced auction of a property is ordered by the enforcement court (*Vollstreckungsgericht*) upon application. The order for a forced auction (*Anordnung der Zwangsversteigerung*) is deemed to be a confiscation (*Beschlagnahme*) of the property in favour of the creditor. The confiscation has the effect of a prohibition on disposal. However, if the confiscation extends to movable property, the debtor may dispose

of individual items within proper administration and such disposal is also effective vis-à-vis the creditor. In the forced auction, the prospective buyers can bid on the property. The creditor is paid out of the proceeds of the auction up to the amount of the security deposit. Any excess auction proceeds will be contributed to the insolvency estate.

Unlike forced auctions, a receivership aims to preserve the property for the existing owner (which is borrower or a third-party security grantor). The unpaid loan and interest will be paid out of the property's ongoing income (eg, rent or lease). A court-appointed administrator (*Zwangsverwalter*) collects the rent or lease payments and covers necessary property expenses. Any remaining surplus is paid to the creditor.

Unless prohibited by the security agreement, the creditor may also realise a land charge by selling it by private agreement to a third party.

Share Pledge

German law does not generally permit the appropriation of pledged assets by the pledgee upon enforcement of the pledge. The enforcement of a share pledge usually requires the sale of the asset constituting the collateral through a formal process involving a public auction to which certain waiting periods and notice requirements apply (or a transfer in the form of collection or in lieu of payment at estimated value).

Account Pledge

In the case of an account pledge agreement, the creditor first submits a written application to the competent enforcement court, precisely specifying the pledged account(s). If the conditions for enforcement are met and the court issues a seizure order (*Pfändungsbeschluss*), the judicial officer (*Rechtspfleger*) will seize the claim

that the debtor has against the bank holding the account. The bank is thereby ordered not to pay out the account funds to the debtor. At the same time, the court orders the realisation of the claim by transfer at the creditor's request. The creditor may then demand payment of the pledged account balance from the bank to itself in the amount specified in the account pledge agreement. However, the creditor can make use of its pledge on the account even before the pledge matures (*Pfandreife*) by no longer allowing the security grantor to dispose of the accounts and block them.

Assignment

The assignment of claims usually is enforced by collection. With an assignment, the lender or the security agent (as the case may be) becomes the statutory owner of the assigned claims. Until a certain enforcement trigger, the assignee is, however, not entitled to collect.

Due to the nature of the assignment of security as an attachment-equivalent, there is no uniform answer as to what rights the secured party has vis-à-vis the collateral provider's other creditors in the event of their enforcement access to the assigned claim. A creditor of the security grantor will not be able to enforce the assigned claims, as ownership of the claims has already been transferred to the lender/security agent. However, the ownership position is not upheld on insolvency. The lender/security agent is only entitled to early satisfaction (ie, has a right to separate satisfaction).

7.2 Enforcement of Foreign Judgments

A general distinction exists between the enforcement of foreign judgements of EU-members and other foreign countries:

General Rules for Enforcement

In order to have a foreign judgment declared enforceable in Germany, the judgment creditor must file an *exequatur* proceeding request. The *exequatur* action is an adversarial proceeding to which the general procedural rules apply. Since recognition has an *ipso iure* effect it cannot in principle be challenged by legal remedies. However, if a dispute arises between two parties as to whether a foreign judgment is to be recognised, either party may bring a declaratory action to clarify this issue in court.

There are essentially three methods of enforcement available, which are all subject to the “principle of disposition” under civil law and require an application by the judgment creditor to the competent enforcement body:

- Enforcement of movable assets.
- Enforcement of claims to which the debtor is entitled against a third party.
- Enforcement of immovable property.

Special Rules for Enforcement

The primary legal instrument governing the recognition and enforcement of judgments within the European Union is the “Brussels Regulation (Recast)”. This regulation simplifies the process of enforcing judgments across EU member states, including judgments from non-EU countries like the United Kingdom by establishing a streamlined process for enforcement, with limited grounds for refusal. Also, decisions from one EU member state are generally recognised and enforced in Germany without the need for a separate procedure.

The “Lugano Convention” extends the recognition and enforcement of judgments to certain non-EU countries. It provides a similar framework to the Brussels Regulation (Recast) for

these countries. Judgments from Lugano Convention signatory states can be recognised and enforced in Germany under its provisions.

The “Hague Convention on Choice of Court Agreements” facilitates the recognition and enforcement of judgments in civil and commercial matters. It applies when parties have agreed to exclusive jurisdiction in a chosen court. Germany is a party to this convention, and it can apply to foreign judgments if the convention’s conditions are met.

8. Lenders’ Rights in Insolvency

8.1 Rescue and Reorganisation Procedures

Since 1 January 2022, StaRUG has been in force. For the first time, the restructuring of imminently illiquid companies outside of insolvency proceedings is governed within a statutory framework. In contrast to insolvency proceedings, under StaRUG, not all creditors of the distressed borrower have to be included in a restructuring.

StaRUG provides companies in financial crisis with a set of instruments which they can use for restructuring without having to open formal proceedings as required – to the contrary – in insolvency proceedings. The core element of StaRUG is the restructuring plan, which regulates the main restructuring measures and which, in principle, can be drawn up and put into effect without the involvement of the court.

However, creditors must expect interference with their rights when participating in a restructuring plan. Creditors are divided in groups of creditors with comparable legal positions. The creditors may then vote for or against the pro-

posed restructuring plan. If the majority of the creditors in the group accept the restructuring plan, it will come into force, notwithstanding the restriction of rights of minority creditors. However, minority protection applies to creditors who reject the plan.

A restructuring plan cannot be confirmed by the court at the request of a creditor if the creditor is likely to be worse off as a result of the restructuring plan than without the plan. Then the restructuring plan has no effect for creditors who reject the plan. The comparative calculation must therefore show that the creditors will not suffer any greater loss of rights as a result of the restructuring plan than they would face without the restructuring plan.

8.2 Main Insolvency Law Considerations

Lenders' rights to enforce a loan, guarantee or security in insolvency: In the event of an insolvency, lenders are not entitled to enforce their claims by themselves. Only the insolvency administrator can enforce such claims. An exception applies, however, for land charges, which can be enforced by the insolvency administrator or the beneficiary – which usually is the security agent. Security has a special status on insolvency. There are two types of security under German insolvency law:

The right of separation (*Aussonderungsrecht*) stating the right to claim the separation of an object from the insolvency estate under a right in rem or in personam is not an insolvency creditor. That person's entitlement to separation of such object is governed by the legal provisions applicable outside the insolvency proceedings. The right of separation applies for any security under which the creditor is not only secured but received full legal status/ownership (eg, security transfer, assignment, however not for pledges).

The right for separate satisfaction (*Absonderungsrechte*) is the more common kind for security. The insolvency administrator is solely authorised to enforce in the security. Nonetheless, the secured creditor is ranked in priority to unsecured creditors to be satisfied out of the proceeds. This is the case, eg, for pledges in claims or property.

Claw-back risks: Under certain conditions, benefits paid before an insolvency can be clawed back and become part of the insolvency estate (*Insolvenzanfechtung*).

If a lender is satisfied before the insolvency proceedings take place and the obligor had the intention to disadvantage the other creditors in the insolvency (in other words, if he paid the claim to favour it), the paid sums count as part of the insolvency estate. The intention to disadvantage other creditors is suspected/presumed if the satisfied creditor knew about the upcoming insolvency.

Equitable subordination/Order of payment: There are different groups of creditors in the insolvency, which are satisfied in the following order:

- secured creditors;
- unsecured creditors;
- creditors, whose claim occur during insolvency proceedings; and
- creditors from shareholder loans (equitable subordination).

In particular, creditors secured by a pledge over the shares in a limited liability company (*GmbH*) or stock corporation (*Aktiengesellschaft*), who, in each case, hold rights which provide influence over the debtor comparable to shareholders. It is likely that the commercial reasoning will also

be applied by the German courts to the newly enacted Section 39 paragraph 1 No 5 of the German Insolvency Code (*Insolvenzordnung*). We are not aware of any case law considering the applicability of these rules to lenders where the loan agreement contains certain covenants which could be characterised as placing the lenders in a position of influence or granting rights to lenders normally considered to be genuine rights of shareholders.

Although the restrictions contained in a facilities agreement are customary, the possibility that a German court may conclude that the covenants contained give the secured parties a degree of control over members of the group of the debtor which is normally reserved to its shareholders and that accordingly such secured parties will be treated as shareholders cannot be excluded. However, it can be opined that a German court should recognise the structural requirements for financings of the kind provided under a customary facilities agreement and should treat such secured parties as third-party providers of funds under normal commercial terms. It is worth nothing that according to recent case law of the BGH (Judgement dated 25 June 2020 – reference no IX ZR 243/18), the classification of a third party loan as a shareholder loan requires that the third-party lender has entrepreneurial influence on the company and that this influence is structured and secured in such a way that it justifies considering the loan of the third party as the use of the capital for its own entrepreneurial activity similar to that of a shareholder.

9. Tax & Regulatory Considerations

9.1 Tax Considerations

German Withholding Tax (Kapitalertragssteuer)

Withholding tax will be levied by a disbursing agent at a flat withholding tax rate of 25% (plus solidarity surcharge (*Solidaritätszuschlag*) at a rate of 5.5% thereon, the total withholding being 26.375%, plus, if applicable, church tax). Church tax (*Kirchensteuer*), if applicable, will be collected by the disbursing agent by way of withholding unless the investor has filed a blocking notice (*Sperrvermerk*) with the German Federal Central Tax Office (*Bundeszentralamt für Steuern*). In the latter case, the investor has to include the savings income in the tax return and will then be assessed to church tax. Further, church tax is not collected by way of withholding if the investment income forms part of income from trade business, self-employment, agriculture and forestry, or letting and leasing.

No withholding tax will be levied if the investor has filed a withholding tax exemption certificate (*Freistellungsauftrag*) with the disbursing agent, but only to the extent the savings income does not exceed the exemption amount shown on the withholding tax exemption certificate. Currently, the maximum exemption amount is EUR1,000 (EUR2,000 in the case of jointly assessed spouses or registered life partners). Similarly, no withholding tax will be levied if the investor has submitted a certificate of non-assessment (*Nichtveranlagungs-Bescheinigung*) issued by the relevant local tax office to the German Disbursing Agent.

Payments made to a creditor resident in a so-called “non-cooperative jurisdiction” (*nicht kooperatives Steuerhoheitsgebiet*) should be subject to a tax deduction by the debtor in Germany

at a rate of 15% (plus solidarity surcharge) of the gross payment pursuant to the Defence against Tax Havens Act (*Gesetz zur Abwehr von Steuer-ervermeidung und unfairem Steuerwettbewerb und zur Änderung weiterer Gesetze*, or StAbwG). However, pursuant to recently introduced legislation no withholding tax will be levied if bearer notes which are represented by a global note (*Sammelurkunde*) are held in collective safe custody with a central depository or similar instrument are tradable on a recognised stock exchange. The exact scope of this exemption is, however, unclear.

Tax Assessment

If no withholding tax has been levied other than by virtue of a withholding tax exemption certificate (*Freistellungsauftrag*) and in certain other cases, the investor is nevertheless obliged to file a tax return, and the savings income will then be taxed within the assessment procedure (*Veranlagungsverfahren*). If the investor is subject to church tax and has filed a blocking notice (*Sper-vermerk*) with the German Federal Central Tax Office (*Bundeszentralamt für Steuern*), the investor is also obliged to include the savings income in the tax return for church tax purposes.

However, also in the assessment procedure, savings income is principally taxed at a separate tax rate for savings income (*gesonderter Steuertarif für Einkünfte aus Kapitalvermögen*) being identical to the withholding tax rate (26.375% – including solidarity surcharge (*Solidaritätszuschlag*) plus, if applicable, church tax). In certain cases, the investor may apply to be assessed on the basis of its personal tax rate if such rate is lower than the above-mentioned tax rate. Such application can only be filed consistently for all savings income within the assessment period. In case of jointly assessed spouses or registered

life partners the application can only be filed for savings income of both spouses/life partners.

When computing the savings income, the saver's lump sum amount (*Sparer-Pauschbetrag*) of EUR1,000 (EUR2,000 in the case of jointly assessed spouses or registered life partners) will be deducted. The deduction of the actual income related expenses, if any, is excluded. That holds true even if the investor applies to be assessed on the basis of its personal tax rate.

Trade Tax (*Gewerbsteuer*)

Where, eg, notes form part of a trade or business, the withholding tax, if any, will not satisfy the personal or corporate income tax liability. The respective holder must include income and related (business) expenses in the annual tax return and the balance will be taxed at the holder's applicable tax rate. Withholding tax levied, if any, will be credited as advance payment against the personal or corporate income tax liability of the holder or, to the extent exceeding this personal or corporate income tax liability, be refunded. Where notes form part of a German trade or business the current income and gains from the disposal, redemption, repayment or assignment of the Notes may also be subject to German trade tax. The trade tax liability depends on the municipal trade tax factor (*Gewerbsteuerhebesatz*). If the holder is an individual or an individual partner of a partnership, the trade tax may generally be completely or partly credited against the personal income tax pursuant to a lump sum tax credit method.

Interest, including accrued interest, and capital gains (which include currency gains and losses, if any) from the disposal, redemption, repayment or assignment of debt received by respective creditor who are not tax resident in Germany are generally not subject to German taxation.

In case of securities, note holders who are not tax resident in Germany may become subject to German withholding tax in case they receive the proceeds by way of an over-the-counter transaction (*Tafelgeschäft*) by a disbursing agent and the notes are not held in custody with the same disbursing agent. Subject to certain requirements, a creditor who is not tax resident in Germany may benefit from tax reductions or tax exemptions provided by an applicable double taxation treaty (*Doppelbesteuerungsabkommen*).

9.2 Regulatory Considerations

Banks and other financial institutions operating in Germany are regulated by financial supervision at both the EU and national levels. Engaging in lending activities is considered a licensable banking operation and requires prior authorisation from the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, or BaFin).

While loan agreements can be drafted as freely as possible, various regulatory requirements must be observed for securities offerings. Offering and selling debt securities in Germany is mainly restricted by its requirement for a securities prospectus for any public offering or listing on a regulated market. Even though facilities agreements are mainly freely negotiable, lenders often request a certain set of representations and undertakings regarding regulatory applications which applies to the business of the borrower, eg, environmental, social, medical regulations.

Borrowing does not constitute a regulated activity in Germany.

10. Jurisdiction-Specific or Cross-Border Issues

10.1 Additional Issues to Highlight

The main German-specific features and cross-border issues are highlighted above. In addition, readers may be interested in German over-collateralisation rules, which may have an impact on the validity and enforceability of security where the value of the security is disproportionately higher than the amount of debt secured by that security.

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