

# Ten things to consider when you do a leveraged finance deal in Germany

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As forecasted in our 30 January 2017 publication “[European leveraged debt fights back](#),” we expect 2017 to be a year where high yield bonds and covenant light "term loan B" loans battle for market prominence. As leveraged finance markets pick up, Germany is becoming a hot market for high yield bonds and covenant light loans. Here are ten things to consider when doing a leveraged finance deal in Germany:

### Sanctions

Contractually agreeing to comply with non-German or non-EU sanctions, such as US OFAC sanctions, is a violation of German law under sec. 7 of the German Foreign Trade Ordinance (*Verordnung zur Durchführung des Außenwirtschaftsgesetzes*). Facility, underwriting and purchase agreements often contain representations, warranties and undertakings requiring obligors and issuers to comply with such sanctions. In order to avoid a violation of the German Foreign Trade Ordinance by the parties to such agreements (whether as obligors/issuers or lenders/underwriters/note purchasers), the relevant representations, warranties and undertakings relating to such sanctions will need to be tailored appropriately.

### Accessory vs. Non-Accessory Security

Security rights under German law have historically been accessory in nature. This means that validity and enforceability is strictly linked (*accessory*) to the existence, the extent and the enforceability of the underlying secured claim. Subsequently, a new type of security rights known as non-accessory security rights developed under German law to address certain disadvantages of accessory security rights and to provide banks and other lenders with a more efficient way of taking security. In contrast to accessory security rights, non-accessory security rights are independent and abstract to the existence, the extent and the enforceability of the underlying secured claim. For example, a German law share pledge is accessory security whereas a German law security assignment is non-accessory security. Under German law, there are different requirements for the creation, release and transfer of accessory security versus non-accessory security. The appropriate requirements need to be followed in order to ensure that the creation, release and/or transfer is valid and enforceable under German law.

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## Materialized vs. Dematerialized Shares

Shares materialized in the form of a deed, if not held in a German securities account under German law, must be securely stored in an appropriate location to ensure that any security created over the shares is validly created and perfected. Depending on the location of the security agent, alternative arrangements must be made for their safekeeping to comply with German law requirements.

## Transfers, Amendments and Debt-Push-Downs

Under German law, a transfer of secured claims will not automatically result in the transfer of all types of German security and, in some cases, can result in the automatic extinguishment of that security. Similarly, certain amendments to loan agreements will affect the validity of German guarantees and security. Accordingly, transfers and amendments involving German guarantees or security must be structured in a way to ensure that guarantees and/or security are validly preserved. A debt-push-down can, in some cases, also affect the validity of German guarantees and/or security if the security documentation does not include appropriate protections.

## Equitable Subordination

Under sec. 39, para 1, no. 5 of the German Insolvency Code, all claims for the repayment of a shareholder loan are subordinated and rank close to equity upon insolvency of a German company and therefore may only be satisfied after the claims of all other secured and unsecured creditors of the company have been fully satisfied or discharged. Transactions must be appropriately structured where a shareholder of a company is also providing funds to the company as a creditor in order to avoid shareholder loans being deeply subordinated as a matter of German law.

## Financial Assistance

German law places restrictions on certain types of German entities (e.g. stock companies and limited liability companies) granting financial assistance within their group, which includes not only direct loans but also up- and cross-stream security and guarantees. Depending on the type of entity providing the up- and cross-stream security or guarantees, appropriate limitation language accepted by the market or a change in the legal form of the entity may be required to preserve the validity of the up- and cross-stream security or guarantees.

## Tax Groups

Under German law, tax groups (*Organschaft*) can be created within a company's group structure to minimize corporate income and trade tax burdens and to achieve a debt-push-down. Implementing such tax groups must be carefully considered to avoid any conflicts with the financing structure, and *vice versa*.

## KG Structures

Using a limited partnership (*Kommanditgesellschaft* or *KG*) as an obligor can be an attractive option for leveraged finance transactions for tax reasons. Under German law where a *KG* is involved, certain substance requirements must be maintained and certain protective provisions must be included in the financing documents to protect creditors and the validity and enforceability of security and guarantees.

## Corporate Governance Structures

German stock corporations have dual corporate governance structures with a management board (*Vorstand*) and a supervisory board (*Aufsichtsrat*). These structures differ from the traditional "board of directors" governance seen in the United States, for example. This dual corporate governance structure has an impact on the provisions required in finance documents and has different requirements in relation to board representation versus shareholder representation, and *vice versa*. For example, change of control provisions in finance documents will need to reflect the dual corporate governance structure.

## Self-dealing

Under sec. 181 of the German Civil Code (*Bürgerliches Gesetzbuch*), there is a prohibition on the ability to contract with oneself. The general rule is that a person cannot enter into a legal transaction in the name of the principal with himself in his own name or as an agent of a third party. This issue often arises where the same authorized person is signing finance documents on behalf of multiple obligors or security providers. Where applicable, an appropriate waiver/release or other solution needs to be implemented to avoid violating this provision of the German Civil Code.

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