Chambers
AND PARTNERS

CHAMBERS GLOBAL PRACTICE GUIDES

Banking & Finance 2024

Definitive global law guides offering comparative analysis from top-ranked lawyers

Germany: Law and Practice

Michael Josenhans, Christina Banz and Anouschka Zagorski
Freshfields Bruckhaus Deringer

GERMANY

Law and Practice

Contributed by:
Michael Josenhans, Christina Banz and Anouschka Zagorski
Freshfields Bruckhaus Deringer

Contents

1. Loan Market Overview p.5
1.1 The Regulatory Environment and Economic Background p.5
1.2 Impact of Global Conflicts p.5
1.3 The High-Yield Market p.6
1.4 Alternative Credit Providers p.6
1.5 Banking and Finance Techniques p.6
1.6 ESG/Sustainability-Linked Lending p.7

2. Authorisation p.7
2.1 Providing Financing to a Company p.7

3. Structuring and Documentation p.8
3.1 Restrictions on Foreign Lenders Providing Loans p.8
3.2 Restrictions on Foreign Lenders Receiving Security p.8
3.3 Restrictions and Controls on Foreign Currency Exchange p.8
3.4 Restrictions on the Borrower's Use of Proceeds p.8
3.5 Agent and Trust Concepts p.8
3.6 Loan Transfer Mechanisms p.8
3.7 Debt Buyback p.9
3.8 Public Acquisition Finance p.9
3.9 Recent Legal and Commercial Developments p.9
3.10 Usury Laws p.10
3.11 Disclosure Requirements p.10

4. Tax p.10
4.1 Withholding Tax p.10
4.2 Other Taxes, Duties, Charges or Tax Considerations p.10
4.3 Foreign Lenders or Non-money Centre Bank Lenders p.10

5. Guarantees and Security p.11
5.1 Assets and Forms of Security p.11
5.2 Floating Charges and/or Similar Security Interests p.12
5.3 Downstream, Upstream and Cross-Stream Guaranties p.12
5.4 Restrictions on the Target p.13
5.5 Other Restrictions p.13
5.6 Release of Typical Forms of Security p.13
5.7 Rules Governing the Priority of Competing Security Interests p.14
5.8 Priming Liens p.14

6. Enforcement p.14
6.1 Enforcement of Collateral by Secured Lenders p.14
6.2 Foreign Law and Jurisdiction p.15
6.3 Foreign Court Judgments p.15
6.4 A Foreign Lender's Ability to Enforce Its Rights p.16

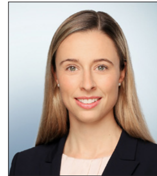
7. Bankruptcy and Insolvency p.16
7.1 Impact of Insolvency Processes p.16
7.2 Waterfall of Payments p.16
7.3 Length of Insolvency Process and Recoveries p.16
7.4 Rescue or Reorganisation Procedures Other Than Insolvency p.17
7.5 Risk Areas for Lenders p.18

8. Project Finance p.18
8.1 Recent Project Finance Activity p.18
8.2 Public-Private Partnership Transactions p.19
8.3 Governing Law p.19
8.4 Foreign Ownership p.20
8.5 Structuring Deals p.20
8.6 Common Financing Sources and Typical Structures p.20
8.7 Natural Resources p.20
8.8 Environmental, Health and Safety Laws p.21

Freshfields Bruckhaus Deringer is a leading international globally integrated law firm offering clients dedicated legal advice across all legal fields and industry sectors in all important economic regions. With over 2,800 lawyers and 29 offices in 18 countries across Europe, Asia and the USA, it is among the largest law firms in the world. The firm specialises in complex, cross-legal and cross-border matters and combines in-depth industry knowledge with innovative solutions to help its clients grow, strengthen and defend their businesses. In the finance sector, the firm's advice covers corporate finance, acquisition finance, leveraged finance, real estate finance, financial restructuring, finance regulatory, equity and debt capital markets, securitisation and structured, project and asset finance.

Authors

Michael Josenhans advises on banking and finance matters with a focus on syndicated loan transactions, including corporate finance, acquisition finance, leveraged finance and infrastructure finance. He is a member of Freshfields' Global Transactions group and of the Private Capital Sector group. He has advised lenders, sponsors and borrowers for more than 20 years throughout Europe and the USA on the full range of credit and debt financings. His experience grants him a deep understanding of complex issues and the rapidly changing market. Numerous corporate clients, sponsors, banks and debt funds rely on his advice for their most important financings or capital restructurings.



Christina Banz is a principal associate in Freshfields' finance practice, specialising in acquisition, leveraged and real estate finance. She is qualified as a solicitor in England and Wales, and is also a German lawyer (Rechtsanwältin). Christina has extensive experience advising on growth debt, direct lending, syndicated loan transactions and English law-governed finance transactions. She regularly advises lenders, sponsors and borrowers on the full range of credit and debt financings, and has a deep understanding of market trends and deal complexities.

Anouschka Zagorski is a member of Freshfields' Global Transactions group and is the head of the English law finance team in Vienna, with a special focus on the CEE region. Anouschka is qualified as a solicitor in England and Wales, and is also a German lawyer (Rechtsanwältin). Her experience includes advising borrowers and financial institutions on project, corporate, real estate, acquisition, asset and ECA finance transactions, as well as refinancings and restructurings.

Freshfields Bruckhaus Deringer

Bockenheimer Anlage 44
60322
Frankfurt am Main
Germany

Tel: +49 69273080
Fax: +49 69232664
Email: michael.josenhans@freshfields.com
Web: www.freshfields.com

Freshfields Bruckhaus Deringer

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Regulatory Environment

In recent years, developments in the German loan market have mainly been shaped by the Capital Requirements Regulation (CRR) and the UCITS V Implementation Act. The CRR (which is based on the Basel III framework) imposes strict capital adequacy requirements on banks and requires them to maintain certain leverage ratios. This heavy regulation has caused regulated lenders to withdraw from certain areas of the lending business, thereby creating a gap. Since the introduction of the UCITS V Implementation Act in March 2016, which amended the German Capital Investment Code (*Kapitalanlagegesetzbuch*) and the German Banking Act (*Kreditwesengesetz*) to allow certain alternative investment funds to originate loans to German borrowers, this gap has gradually been filled by alternative credit providers.

Impact of Recent Economic Cycles

After undergoing a recession in 2023, the German economy was expected to stagnate in 2024 – thus the demand for loans remained low in early 2024 and continues to stay below the level of previous years. Another factor which limits businesses' need for new loans is their reduced appetite for investments owing to the prevailing economic uncertainty. Nonetheless, although the recovery of the loan market may take longer because of Germany's weak economic recovery, some growth for the second half of 2024 is expected. The lowering of interest rates by the European Central Bank (ECB) in June 2024 as well as the recent results of the Bank Lending Survey (BLS) of the *Deutsche Bundesbank* are indicators that the tightening cycle of the banks' lending criteria may come to an end. However, the loan market will most likely move sideways until the economic uncertainty has been overcome.

1.2 Impact of Global Conflicts

As mentioned in **1.1 The Regulatory Environment and Economic Background**, economic uncertainty is a main factor for the slow growth of the loan market. Supply chains are threatened by the ongoing trade wars, the Russian invasion of Ukraine and the crisis in the Middle East, to name just a few causes. Consequently, enterprises face continuing rising costs – including higher interest costs – which may lead to an increase of loan defaults.

Still, even though the challenging geopolitical environment hampers demand, many companies look for a way to refinance their ongoing business. One example of this concerns Russia's ongoing war in Ukraine, which triggered a wave of transactions with investors seeking to offload Russian assets and investments.

While the direct claims of German financial intermediaries against debtors in Russia were small, the war in Ukraine still has far-reaching effects on German markets. In particular, it has caused unprecedented energy cost rises, disproportionately affecting German companies given their high reliance on Russian oil and gas. At the same time, this has caused a substantial increase of investments and financial demand in the energy transition area.

On the borrower side, those with solid businesses are still seeking to refinance existing loans to secure lower rates and better financial terms, where possible. Borrowers with highly impacted businesses, however, often find themselves in lengthy negotiations with lenders to obtain waivers of financial covenants, extensions of existing loans or adjustments of existing terms.

1.3 The High-Yield Market

The high yield market had a strong start going into 2024, with issuances reaching EUR68.72 billion by mid-August – this compared to EUR66 billion in FY 2023, which was already up from EUR45 billion in 2022 (but below the pre-COVID-19 pandemic annual average of around EUR100 billion per year).

Over the years, the German high-yield and leveraged loan markets have gradually assimilated their covenant packages and overall documentation terms. With a growing number of high-yield bond issuances being secured, there is a noticeable number of typical "covenant-lite" provisions in large-cap leveraged term loans.

Despite this trend towards assimilating loan and high-yield documentation terms, certain differences are worth mentioning. In light of the interest rate volatility, some companies have considered issuing fixed-rate notes. Loans generally continue to have more extensive undertakings and events of default, allowing lenders to demand economic or legal adjustments if borrowers seek amendments or waivers.

1.4 Alternative Credit Providers

As mentioned in **1.1 The Regulatory Environment and Economic Background**, there has been a significant increase in alternative credit providers in the German loan market. Debt funds have traditionally focused on small and mid-cap leveraged buyouts but are gradually also financing corporate borrowers and offering unitranche solutions for large-cap leveraged acquisitions, thereby taking market share from the syndicated market.

Direct lending by alternative credit providers typically offers certain benefits over traditional bank lending, including:

- no syndication risk, since the debt is held to maturity;
- flexible and borrower-friendly covenants;
- financing at higher leverage multiples; and
- greater execution speed.

1.5 Banking and Finance Techniques

The unitranche offerings have resulted in a high number of super senior bank products – typically revolving credit facilities and related hedging, though more recently also in the form of additional term debt. This trend has led to new intercreditor arrangements.

The recent trend towards reduced leverage via senior debt, and the need for additional leverage in competitive auctions or distressed situations, has resulted in PIK HoldCo or preferred equity structures. These products, which are provided by the growing number of very flexible "capital solution providers", do not require intercreditor agreements as they are structurally subordinated to the senior loans, though the higher risk triggers a substantial increase in pricing.

1.6 ESG/Sustainability-Linked Lending

Environmental, social and governance (ESG) and other sustainability-linked lending has become a popular component of most lending transactions, especially in the area of syndicated loans through so-called sustainability-linked loans (SLLs). The practical importance of SLLs lies in the field of investment-grade lending and in the manufacturing sector. Next to SLLs, sustainable lending can be undertaken through green loans and social loans. As the names suggest, those need to be tailored to financing an ecological or social target. They are mostly used in the relevant industry for the financing of environmental projects. However, a syndicated social loan transaction has yet to close in Germany.

SLLs, on the other hand, do not need to be used to finance sustainable projects, and can be used for general corporate financing. Companies and lenders typically agree on bespoke ESG performance indicators that are assessed annually through the delivery of company-produced or objective third-party reports. ESG ratings have, however, become less visible in recent years. The interest rate of the borrower is adjusted depending on whether the targets have been met. Although such margin adjustments often only range from one to five basis points, borrowers and lenders also benefit from the positive image resulting from publicly visible ESG commitments. On the downside, the quantity and volume of SLLs did decline in 2023 – reasons for this include that they do generate additional costs for the borrower and for the lender, while only providing little financial incentive for one and no beneficial effect regarding the green asset ratio for the other.

Regarding supply chain monitoring, the financial sector has yet to be fully included within the scope of the new Corporate Sustainability Due Diligence Directive (CSDDD). As of now, only upstream business partners are included in the Directive – meaning those providing goods and services to the financial sector. However, since ESG remains such a hot topic, this might change with the passing of any further regulations on the matter by the EU legislature.

2. Authorisation

2.1 Providing Financing to a Company

In Germany, the granting of loans is subject to a banking licence. Banking licences are granted by the *Bundesanstalt für Finanzdienstleistungsaufsicht* and, if they are combined with a deposit-taking licence, by the ECB. The licence application is a lengthy and burdensome procedure.

The regulatory environment generally does not allow non-banks (institutions that do not hold a banking licence) to act as lenders. However, some narrow exemptions apply. As such, non-banks may co-operate with credit institutions in order to be involved in the loan business (the "fronting-bank model" or the "white label model") or in certain circumstances may rely on the reverse-solicitation exemption (see **3.1 Restrictions on Foreign Lenders Providing Loans**).

Furthermore, no licence is required for the mere acquisition and holding of loan claims, but there is a very fine line between mere "holding" and other actions in respect of those claims (eg, extensions) which again lead to a licence requirement.

In addition, as described in **1.1 The Regulatory Environment and Economic Background**, German investment laws were amended to allow certain EU-regulated credit funds to grant loans under very specific circumstances, even if they do not hold a banking licence.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

The banking licence requirement applies both to domestic lenders and to foreign lenders equally. Certain exemptions may apply for EU institutions that hold a banking licence in their home jurisdiction and that are supervised by competent authorities in their home jurisdiction within the EU. These institutions may passport their banking licence to Germany if they fulfil the relevant requirements.

Generally, the licence requirement applies if foreign lenders wish to provide services to customers who are considered German residents. One exemption to this rule ("reverse solicitation") applies if the customer seeks out the foreign lender explicitly and the foreign lender does not market or advertise their services to German customers as such.

3.2 Restrictions on Foreign Lenders Receiving Security

Generally, foreign lenders may receive security or guarantees in the same way as domestic lenders. The receipt of real estate security might have certain tax implications for foreign lenders.

3.3 Restrictions and Controls on Foreign Currency Exchange

Germany has not implemented foreign currency controls, except for reporting obligations in the case of incoming or outbound payments regardless of currency. However, banks and payment institutions are required to freeze assets of persons subject to EU sanctions lists. This affects all assets – including funds – regardless of currency. Funds subject to an asset freeze are required to be reported to the competent authorities, which is Deutsche Bundesbank in Germany.

3.4 Restrictions on the Borrower's Use of Proceeds

By law, no restrictions on the use of proceeds arise, other than for non-compliance with sanctions or other applicable public laws and the financial assistance/capital maintenance requirements described in **5.3 Downstream, Upstream and Cross-Stream Guaranties** and **5.4 Restrictions on the Target**.

3.5 Agent and Trust Concepts

In syndicated financings, it is market standard to implement an agency and security agency concept. The trust concept is not recognised in Germany. To allow the security agent to hold certain types of security, a parallel debt concept would be included in the financing documentation.

3.6 Loan Transfer Mechanisms

Loan claims can be transferred to a new lender by way of a transfer of rights and claims (*Vertragsübernahme*) or by way of an assignment of claims (*Abtretung*).

Transfer of Rights and Claims

The usual way to trade out of and into a syndicated loan is by transferring all rights and claims of an existing lender to a new lender. The new lender not only assumes the right to demand principal and interest from the borrower but also assumes funding commitments and other obligations of a lender.

Assignment of Claims

In situations where no more obligations remain on the part of the lender (eg, in the case of non-performing loans), loan claims are usually assigned from the existing lender to the new creditor.

Transfer of Security

In both scenarios, certain security ("accessory" security, particularly pledges and mortgages) will, by law, transfer together with the secured claim. A novation of loan claims should therefore be avoided. In respect of other security (the "non-accessory" security, particularly security transfers, security assignments and land charges), the existing and the new lender would need to expressly transfer the security to the new lender, and in some cases certain actions from the security grantor could be required. To avoid this, such security is granted only to the security agent in order to secure the parallel obligations of the debtor towards the security agent, and therefore does not need to be transferred.

3.7 Debt Buyback

A debt buyback by the borrower or the sponsor is often contractually permitted but accompanied by a disenfranchisement of the borrower or sponsor in such case – meaning that, among other things, they cannot participate (and are not counted) in any decision-making by the lenders. Sponsors need to consider a potential equitable subordination based on statutory law. Borrowers also need to keep in mind potential tax consequences.

3.8 Public Acquisition Finance

The acquisition of a German public company requires the inclusion of a certain funds concept in the financing documentation, as by law the purchaser is required to prove that it will have the required funds available at the time the public offer is made. The financing is not published but is only reviewed by an intermediary (a recognised financial institution) which confirms the certain availability of the funds as required by law. For that purpose, strategic buyers will usually already agree on long-form documentation, while in most cases sponsors will agree on a term sheet and a precedent for the long-form documentation from a previous transaction (sometimes accompanied by an interim loan agreement as a fundable document).

3.9 Recent Legal and Commercial Developments

Pre-insolvency Restructurings

Since 1 January 2021, German legislation has established a comprehensive legal framework for voluntary out-of-court restructurings (for details, see **7.4 Rescue or Reorganisation Procedures Other Than Insolvency**). As a result, certain provisions of financing agreements have become subject to increased negotiations, though such renegotiations need to be closely observed in line with the law. For example, certain lenders have intended to include Stabilisation and Restructuring Act (StaRUG) proceedings as an event of default, even though such an event of default provision would be void by law.

Sanctions

The war in Ukraine and sanctions imposed in connection therewith are still drawing close attention to the sanctions clauses in new financ-

ing agreements. While in most cases the previous market standard of broad and flexible sanctions provisions is sufficient to cater for this increased awareness and does not require (many) changes, the continuous development of sanctions laws and banks' internal policies requires a stronger focus on such provisions.

Bail-In

Credit agreements often include contractual recognition clauses that acknowledge the potential application of bail-in powers by resolution authorities. These clauses are intended to facilitate the smooth implementation of bail-in measures and are required in certain circumstances by regulations such as the Bank Recovery and Resolution Directive.

3.10 Usury Laws

In respect of a loan governed by German law, the parties may not agree upfront to compound interest (ie, interest may not be charged on interest) (Section 248(1) BGB) but can do so once the interest is accrued (ie, PIK toggle arrangements are possible). In the case of unpaid interest, default interest may therefore not be applied. However, the same result is reached by agreeing on the obligation to pay lump sum damages (*pauschalierter Schadensersatz*) in the same amount.

3.11 Disclosure Requirements

In general, financing agreements do not need to be publicly disclosed. In initial public offerings (IPOs) and bond offerings, summaries of the underlying financial arrangements may need to be published.

Separately, certain disclosure requirements exist under German banking regulations. Among other requirements, financial institutions need to notify the German Central Bank of loans with a volume of EUR1 million or more (large exposures) together with certain key information on the borrower.

4. Tax

4.1 Withholding Tax

Whether payments of principal, interest or other payments made to lenders are subject to withholding tax depends on the structure and financing in question. The "typical" financing agreement usually triggers no withholding tax. However, a number of important exceptions exist – for instance, those relating to profit-related payments and certain hybrid arrangements. Also, interest secured by German real estate may trigger a limited domestic tax liability.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Besides withholding tax and limited tax liability aspects (as noted in **4.1 Withholding Tax**), lenders are usually not subject to taxes from lending into Germany. In particular, Germany does not levy stamp duty, and net wealth tax is not levied either. VAT may become a relevant aspect in Germany and the EU, but for the most part a VAT exemption applies.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

From a tax perspective, it is important that the lender not be associated with a tax haven jurisdiction. Rather, it is advisable for a lender and beneficial owner of the loan to be tax-resident in a tax treaty jurisdiction with a favourable double tax treaty with Germany. This would give the lender the typical tax protection of a qualifying lender.

5. Guaranties and Security

5.1 Assets and Forms of Security

A comprehensive collateral package will typically comprise collateral over all of the borrower's and/or guarantors' assets to the extent that the cost benefit ratio justifies it.

Most security agreements have standard terms, leaving little room for negotiation. With few exceptions (mentioned below), security agreements can be executed by simple exchange of signatures (electronic, if agreed between the parties).

Shares/Interests/Stocks

Pledge agreements over shares in German limited liability companies (contrary to pledge agreements over interests in partnerships and over stock in corporations) need to be notarised, which incurs high costs. The notarisation is usually attended by the legal advisers of each party based on a power of attorney, possibly requiring certification and legalisation depending on the jurisdiction of the represented party.

The perfection of a pledge requires that the relevant pledged entity be notified of such pledge (implemented either by the relevant pledged entity becoming a party to the agreement for the purpose of such notification or by requiring notification to be sent and evidenced within a certain time period – eg, five business days). In the case of certified stocks, the stock certificates need to be handed over or a substitute of such handover needs to occur. Sometimes, stock certificates need to be endorsed.

Bank Accounts

In correct legal terms, it is not the account as such that is pledged but the rights and claims which the account holder from time to time has towards the account bank in connection with the bank account.

The perfection of account pledges requires that the account bank be notified of the pledge (implemented by requiring such notification to be sent and evidenced within a certain time period – eg, five business days).

Movable Assets

Security transfer agreements require the inclusion of certain details on the location or the identity of the assets and potential rights of third parties (eg, landlords, suppliers or factoring providers). Obtaining the required information on those details from the security provider is a key timing item in this respect.

No perfection requirements exist. However, the transferred assets need to be clearly determinable (*bestimmbar*) by an independent third party. Therefore, close attention needs to be paid to a sufficiently detailed description of the location of the transferred assets or, if necessary, other features which set the transferred assets apart from others (eg, by way of labelling the transferred assets).

Intellectual Property

Intellectual property (IP) rights can be assigned or pledged for security, depending on the exact type of IP and its registration. Security rights over IP need not (but should) be registered with the competent registry to protect the lenders' interests.

Note that electronic signatures are not sufficient in the event that the IP includes trade marks registered with the European Union Intellectual Property Office (EUIPO), and in such case actual wet-ink signatures need to be exchanged.

Receivables

Security assignment agreements need special attention in the case of other/previous assignments of receivables by the assignor – eg, to a factoring provider. Obtaining the required information from the assignor is a key timing item.

A notification of the debtor of the assigned receivable is not required to perfect the security. However, prior to receipt of a notification, the debtor can effectively settle the receivable by way of payment to the assignor. Notifications are therefore common in respect of intra-group receivables and receivables towards professional parties (eg, insurances or report providers) but not in respect of customers.

Real Estate

Security over immovable assets is provided by way of land charges or mortgages. The land charge or mortgage itself is a standard document containing only a formal description of the security right to be established. Therefore, a related security purpose agreement needs to be concluded which includes all other provisions, such as the security purpose and enforcement triggers.

The land charge or mortgage itself needs to be notarised, resulting in additional costs depending on the amount of the land charge or mortgage. Further costs arise for registration with the land registry.

Land charges and mortgages can be certified or uncertified. In the case of an uncertified land charge or mortgage, the security only becomes valid upon its entry into the land registry.

5.2 Floating Charges and/or Similar Security Interests

A floating charge typically describes an instrument which creates security over non-constant assets changing in quantity and quality. However, German law requires that a security interest relate to determinable assets such that these assets are identifiable by a third person familiar with the agreement between the security provider and the security taker. A floating charge would not be compatible with these requirements.

Nonetheless, in a similar way German security interests usually cover all existing and future assets of a certain type (which is possible for all of the security types mentioned in **5.1 Assets and Forms of Security** except for land charges/mortgages).

5.3 Downstream, Upstream and Cross-Stream Guaranties

Under German law, it is generally possible for any entity to provide downstream, upstream and cross-stream guarantees or security.

However, if the guarantee/security provider is a German limited liability company or a limited partnership with a limited liability company as its general partner, by law upstream and cross-stream guarantees/security cannot be provided or may result in personal and criminal liability for the management directors, to the extent that the granting or enforcement of such guarantee/security would lead to a breach of capital maintenance rules (*Kapitalerhaltungsregeln*).

The capital maintenance rules prohibit the direct and indirect repayment (such term to include payments pursuant to guarantees or security in favour of obligations of a direct or indirect shareholder) of registered share capital of a German limited liability company to its sharehold-

ers. Accordingly, by way of so-called limitation language in the respective guarantee/security document, enforcement of up- and cross-stream security will be limited (subject to certain exceptions) if and to the extent that payments under the guarantee or enforcement of the security would directly or indirectly cause the net assets (*Reinvermögen*) of the guarantee/security provider (or, in the case of a partnership, the net assets of the respective general partner) to fall below the amount of its respective registered share capital and, hence, to create personal or criminal liabilities for the management directors.

5.4 Restrictions on the Target

The granting of guarantees, securities or financial assistance is not generally prohibited under German law but is subject to certain restrictions, depending on the legal form of the target, to the extent that it qualifies as a payment to the shareholders of the target.

Restrictions for Limited Liability Companies and Limited Partnerships

If the target is a limited liability company or a limited partnership with a general partner that is a limited liability company, the granting of security or guarantees is subject to the capital maintenance rules set out in **5.3 Downstream, Upstream and Cross-Stream Guaranties**.

Restrictions for Stock Corporations

If the target is a stock corporation (*Aktiengesellschaft*), capital maintenance rules provided in the German Stock Corporation Act (*Aktiengesetz*) generally strictly prohibit payments to shareholders which qualify as a return of capital, unless a fully recoverable repayment claim against the shareholder(s) exists.

Solutions

There is no white-wash procedure in Germany, though the following procedures are usually implemented to avoid the legal consequences potentially arising from a breach of capital maintenance rules:

- inclusion of so-called limitation language in the financing documentation (see **5.3 Downstream, Upstream and Cross-Stream Guaranties**);
- a so-called debt push-down – ie, an assumption of the debt by the target company;
- a merger (*Verschmelzung*) of the target with the acquisition vehicle; or
- the conclusion of a domination and/or profit and loss transfer agreement (*Beherrschungs- und/oder Ergebnisabführungsvertrag*) between the target and its shareholder(s).

5.5 Other Restrictions

The articles of association of entities to be pledged often include provisions requiring the approval of all shareholders for pledges and/or a sale of any shares (*Vinkulierungsklausel*). In such case, shareholder consent for the pledge and for a potential future enforcement of such pledge should be obtained. Ideally, the deletion of such provision is requested and implemented prior to, or at least shortly after, the execution of the pledge agreement. Other restrictions are uncommon but could be included in the articles of association, which would therefore need to be reviewed.

5.6 Release of Typical Forms of Security

All types of security mentioned in **5.1 Assets and Forms of Security** can be released by way of a release agreement, which can be executed by simple signature (ie, no notarisation is required in respect of the notarised security rights).

The release of a land charge/mortgage needs to be entered into the land registry in order to become effective. All other security rights cease to exist at the time agreed in the release agreement. The release of the pledges and assignments is usually (but need not be) notified to the relevant debtors (if they have also been notified of the pledge or assignment).

5.7 Rules Governing the Priority of Competing Security Interests

Certain security interests (in particular, security transfers of movable assets and assignments of receivables) can only be established once and can therefore only exist in one rank. However, it is possible to ensure that the proceeds of such security be applied in a different order to groups of creditors, by providing the security to a security agent and contractually agreeing on the order of application – for example, in an intercreditor agreement.

Security interests over shares/interests/stocks, bank accounts and land can be provided multiple times in different ranks. Such security interests will rank in the order of their valid establishment (priority rule). Nonetheless, in non-distressed financings, usually only one rank of security is established, and the order of application is agreed in an intercreditor agreement, as described above. In deviation thereof, in scenarios in which different secured claims face different insolvency claw-back rights, it is common to provide individual, different ranking security rights to different creditor groups.

5.8 Priming Liens

There are two types of security existing by law, which usually rank prior to the contractual security rights of lenders.

Pledge by the Account Bank

Account banks usually have a right of pledge over the accounts opened with them based on their general terms and conditions for any claims arising against the pledgor in connection with the account. Account pledge agreements therefore usually request the pledgor to undertake reasonable efforts such that the account bank waives or subordinates such pledge. A strict requirement for such waiver or subordination is usually not included, given the limited scope of the secured obligations under such pledge pursuant to the general terms and conditions.

Landlord's Right to Movable Assets on Leased Premises

A landlord of leased premises has a statutory right of pledge over the lessee's assets brought onto the premises for any claims arising in connection with the lease. Given the limited scope of the secured obligations under such pledge, it is unusual to include a requirement that such pledge be waived. However, recent transactions have sometimes seen a requirement for the lessee to regularly provide proof of rent payments, in order for lenders to be able to assess the risk associated with the prior ranking pledge of the landlord on a regular basis.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

By law or pursuant to the relevant security agreement, the enforcement of German collateral is only possible if and once the secured claims have become due and payable. In many cases, security agreements contain (additional) conditions, requiring an event of default to have occurred and be continuing and/or the loan to have been accelerated. However, certain pre-

enforcement securing steps are sometimes permitted without a due and payable claim as long as an event of default is continuing.

Enforcement by law generally requires the enforcing creditor to obtain an enforcement title in court. This requirement is often either waived (eg, in share pledges) or avoided by immediate submission to foreclosure (eg, in land charge deeds).

The further enforcement procedure depends on the type of security, as follows.

- A security assignment over claims is enforced by the secured party collecting any claims from the debtors.
- A surety or guarantee is enforced by seeking a court title for payment against the debtor.
- A share pledge is enforced by way of a public sale (ie, an auction). This is subject to a prior notice period typically limited to five business days. After the secured debt has become enforceable, the pledgor and pledgee may also agree on a private sale – a forced private sale or appropriation is not permitted.
- An account pledge is enforced by instructing the account bank to pay any amounts standing to the credit of the account to the pledgee.
- Land charges/mortgages are primarily enforced by way of public auction. This process can be expected to take at least 12 months. Where the charged real property generates income, it is also possible to place the property into forced administration and to use the generated income to pay down the secured debt – this is often quicker. In any event, the enforcement of a land charge requires that six months' prior notice be given to the debtor.

6.2 Foreign Law and Jurisdiction

In general, parties may contractually agree on the governing law of their agreements. Under the Rome I Regulation (Regulation (EC) No 593/2008), in general the parties have the right to choose any governing law, even without a specific connection to the case.

Similarly, the parties may contractually agree to submit to a foreign jurisdiction. Depending on which foreign jurisdiction is chosen, this submission will be legally binding in accordance with different applicable regulations, conventions or laws.

A waiver of immunity will generally be upheld by German courts. However, assets that serve a specific public purpose generally benefit from sovereign immunity under German law (Section 882a of the German Code of Civil Procedure).

6.3 Foreign Court Judgments

Under the Brussels I Regulation recast (Regulation (EU) No 1215/2012), judgments in civil and commercial matters delivered within an EU member state are (with very limited reasons for rejection) automatically acknowledged in all EU member states, regardless of whether or not the judgment is final and binding.

When the fundamental criteria for recognition (or rejection) are governed by an international treaty, German courts will apply those criteria.

In all other cases, the foreign judgment must be both final and binding. According to Section 328 of the Code of Civil Procedure (ZPO), a foreign judgment will be acknowledged in Germany if no grounds for rejection (delineated in Section 328(1) of the ZPO) are applicable. The party seeking recognition bears the responsibility of

proving that the elements required for recognition are present.

6.4 A Foreign Lender's Ability to Enforce Its Rights

A foreign lender can generally enforce its rights in the same way as a domestic lender.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The court order opening insolvency proceedings imposes an automatic stay on any enforcement actions by unsecured creditors against the company. Unsecured creditors can only enforce their rights within the legal framework of insolvency proceedings – ie, substantially filing their claims to the insolvency table with the insolvency officeholder to receive the insolvency dividend (pro rata payment). In practice, the court often imposes such stay even prior to the formal commencement of insolvency proceedings in so-called preliminary insolvency proceedings.

The Insolvency Act does not impose an automatic stay on the enforcement by certain (secured) creditors. Generally speaking, the following rules apply.

- Creditors who can demonstrate that they have ownership (title) in an asset or similar rights in rem or other absolute rights which, therefore, are not part of the insolvency estate (segregation right, *Aussonderungsrecht*) have a claim for restitution of the relevant asset – eg, suppliers with (simple) reservation of title rights (*einfacher Eigentumsvorbehalt*).
- Creditors with security interests in assets forming part of the insolvency estate have a right to separate satisfaction (*Absonderungsrecht*) (ie, they may seek preferential satisfaction of their claims from the proceeds of the liquidation of the relevant asset). However, the Insolvency Act provides for specific rules regarding the responsibility and process in relation to the enforcement of such security interests.

7.2 Waterfall of Payments

The proceeds realised by the insolvency officeholder (note the exceptions under **7.1 Impact of Insolvency Processes**) will generally be distributed to the creditors pursuant to the following waterfall:

- costs of insolvency proceedings and so-called administrative claims (*Masseverbindlichkeiten*) (ie, specifically including claims arising from transactions executed by the insolvency officeholder after the commencement of insolvency proceedings);
- unsecured claims (*Insolvenzforderungen*) pari passu; and
- subordinated claims (*nachrangige Insolvenzforderungen*) (ie, interest accruing after the commencement of insolvency proceedings or certain shareholder loans – for instance, by shareholders holding more than 10% of the registered share capital provided they are not part of the management board).

7.3 Length of Insolvency Process and Recoveries

The sale of a company on a going-concern basis out of insolvency (asset deal) is typically consummated within three to six months. The completion of the proceedings for corporate insolvencies – including any litigation, admission of claims, distribution of the insolvency estate, etc – can take several years depending on the size of the company and/or the complexity of the matter. If the insolvent company implements an

insolvency plan, the timeframe also varies from a few months to several years.

The range of the insolvency dividends distributed in German insolvency proceedings varies widely. The rights of segregation and rights to separate satisfaction are usually not included in insolvency statistics in Germany. These depend on the value of the collateral in each individual case. For insolvency proceedings commenced in 2011 and concluded by 31 December 2018, the average dividend of unsecured creditors amounted to 6.1% (see German Federal Statistical Office (Destatis), 2020, Reference (Fachserie) 2, series 4.1.1, p 4).

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

StaRUG

Since 1 January 2021, the Stabilisation and Restructuring Act (StaRUG) (implementing the EU Restructuring Directive of 20 June 2019 – Directive (EU) 2019/1023) provides for a comprehensive legal framework for voluntary out-of-court restructurings.

In principle, a debtor with its centre of main interest in Germany has access to StaRUG proceedings if it faces imminent illiquidity (*drohende Zahlungsunfähigkeit*) but not yet illiquidity (cash-flow insolvency, *Zahlungsunfähigkeit*) or over-indebtedness (balance sheet insolvency, *Überschuldung*) (each as defined in the German Insolvency Act).

StaRUG then allows the debtor to implement a financial restructuring and bind all creditors, including classes that do not approve the plan, through a cross-class cram-down. Operational restructuring measures, however, continue to require a consensual agreement of all affected parties (for example, the termination of long-term contracts such as lease agreements is not feasible under StaRUG).

If a new financing is required to implement the restructuring, such financing will, in principle, be excluded from claw-back and lender liability in subsequent insolvency proceedings. However, as these privileges only apply for a limited timeframe until the debtor is sustainably restructured, in practice lenders will continue to rely on a restructuring opinion (S6-Sanierungsgutachten) to reduce risks (see **7.5 Risk Areas for Lenders**).

SchVG

The German Bond Act 2009 (SchVG) provides for an out-of-court restructuring procedure in relation to bonds governed by German law. Provided and to the extent that the terms and conditions of the bond provide for the possibility to amend these by way of a bondholders' resolution, the SchVG allows for a wide range of restructuring measures. These include:

- a waiver of principal and/or interest;
- deferrals;
- a debt-for-equity swap; and
- modifications of the terms and conditions of German bonds.

For major decisions (such as waivers or debt-for-equity swaps), the resolution of bondholders generally requires a quorum of 50% by value of the bonds in the first bondholders' meeting, and, if the quorum is not met, 25% by value in a second bondholders' meeting. No quorum is required for other decisions.

The majorities that must be obtained to approve the resolution for major decisions are 75% of bondholders by value present and voting in the bondholders' meeting and more than 50% for any other decisions (such as the appointment of

a joint representative). The bondholders' resolution is subject to appeal within one month. A successful appeal will nullify the resolution.

7.5 Risk Areas for Lenders

Insolvency Claw-Back

Certain pre-commencement transactions are subject to insolvency claw-back actions by the insolvency officeholder, provided certain conditions are met. Generally speaking, to be subject to claw-back, the relevant transaction must have occurred prior to the commencement of insolvency proceedings and must have disadvantaged the debtor's creditors (indirect effects being sufficient).

Finance documents therefore typically contain information obligations aimed at providing regular and, in the event of arising difficulties, early visibility of the borrower's financial situation.

Lender Liability

Under German law, if a lender refuses to grant a (new) loan to the distressed company, accelerates its (existing) loans or refuses to (partially) waive its claims, thereby causing the company's insolvency, the lender generally cannot be held liable, as it has no legal obligation to participate in the restructuring or remediation measures of the company. Nonetheless, lenders need to carefully consider the legal implications of their actions for the borrower's directors, given the relatively strict personal/criminal insolvency liability regime.

However, liability can, under certain circumstances, be construed on the fact that granting or extending a loan caused or assisted the debtor's delay in filing for insolvency. When granting new loans or extending maturities of existing loans to borrowers in distress, lenders therefore typically request the issuance of a restructuring opinion pursuant to an industry standard (IDW S6) by independent experts, essentially objectively confirming that the borrower can be restructured.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance activity in Europe is spread across many sectors but continues to show a clear tendency towards infrastructure projects. In the near to mid-term, a particular focus will be on infrastructure required for the energy transition and transportation.

Energy Transition

Germany's energy transition targets include for renewable energies to make up 60% of the gross final consumption of energy and 80% of the gross electricity consumption by 2050. For this purpose, it is estimated that around EUR600 billion of investments will be required in (among others) the areas of energy production, electricity grid expansion, energy storage and electrification of the transport sector.

Transportation

In the 2030 Federal Transport Infrastructure Plan, the German government identified the need for EUR270 billion to renew and expand various federal motorways, railway infrastructure and waterways until 2030, and the current government is strategising on substantial allocations for the enhancement and expansion of the rail network following the "Germany Pulse" (*Deutschlandtakt*) framework.

8.2 Public-Private Partnership Transactions

Legal Framework

In Germany, public-private partnerships (PPPs) are usually based on a civil agreement between a public partner and a private entity. The public partner can be the Federal Republic, a federal state or one of its authorities, or a local community, while the private partner is a legal entity or a joint venture with several entities as shareholders. No specific laws on PPPs have been enacted, though general rules of corporate and financing laws (and, because of the public aspect of the partnerships, EU and national public procurement rules) apply. The PPP Acceleration Act of 2005 (*ÖPP-Beschleunigungsgesetz*) provided for a number of amendments to existing legislation to facilitate PPPs.

Identification of Possible Projects

At first, the public partner in respect of a project needs to assess the overall justification for a PPP. Federal and state budget laws require the economic efficiency to be substantiated through a detailed economic plan of the project and its comparison with an implementation of the project by way of a "conventional" procurement process. In addition, compliance with EU subsidies law must be ensured.

Preparation Phase

Thereafter, the public partner develops the main project contracts and specifications of the project, and determines the project's main aspects, such as:

- its term;
- its corporate set-up;
- its equity and financing;
- a suitable contract model; and
- the required level of public control.

The administrative framework of the PPP can require a certain type of structure to retain certain levels of public control over the project.

Award and Negotiations

Once the main terms have been prepared, the public partner finds its private partner through a contract award procedure. According to Section 2 of the Procurement Ordinance (*Vergabeverordnung*), the PPP project is subject to a formal award procedure if its volume exceeds a certain threshold, whereas budget laws may require a tender even if the project remains below such threshold. Procurement regulations frequently necessitate a Europe-wide tender and grant the applicant the right to pursue legal remedies before a public procurement tribunal.

Implementation

Once the project has been awarded and the PPP has been finally negotiated and established, the implementation of the project commences. During this phase, all laws applicable to the relevant project matter need to be observed.

8.3 Governing Law

Generally, parties are free to agree on the applicable law governing the agreements (see **6.2 Foreign Law and Jurisdiction**). However, if the project is (or if the relevant assets are) located in Germany, parties usually prefer that German law govern all or some of the agreements to ensure consistency and enforceability in Germany.

The parties can also agree to submit the contract to arbitration proceedings. Germany is a party to several dispute resolution agreements, including but not limited to:

- the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (the "New York Convention");

- the Energy Charter Treaty of 1964;
- the Geneva Protocol on Arbitration Clauses of 1923; and
- the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (the "ICSID Convention") of 1965.

8.4 Foreign Ownership

Germany generally embraces foreign investments and maintains an open and accommodating stance in this regard, imposing minimal restrictions on such investments. In general, no restrictions exist on foreign entities owning real property or other resources in Germany. However, in certain exceptional cases, the government needs to be notified and may veto a transaction.

8.5 Structuring Deals

Project finance transactions are commonly structured as non-recourse financings in which the project company is set up as a special purpose vehicle. The financing is fully repaid through the free cash flow of the project company; sponsor guarantees are uncommon.

The project company will most commonly be a limited partnership (*Kommanditgesellschaft*) in which a limited liability company (*Gesellschaft mit beschränkter Haftung*) (GmbH) holds the position of the general partner (GmbH & Co KG). Equity contributions are typically made by the sponsors as limited partners. The shares in the general partner are typically held by the sponsors pro rata to their shares as limited partners. Alternatively, they can be held by the limited partnership itself (*Einheitsgesellschaft*), which facilitates transferability.

Further structuring will depend on the risk allocation between the parties and will be subject to all German and EU laws and regulations applicable to the sponsors, the lending entities, the project company and the sector.

8.6 Common Financing Sources and Typical Structures

Financing is usually provided by way of a (senior) bank financing to the project company and subordinated shareholder loans. In certain structures, mezzanine or subordinated PIK HoldCo financing may be taken up by the project company's holding company.

Alternative debt providers play an increasingly important role in debt funds funding into German project financings, by way of:

- subordinated or mezzanine financing;
- bridge loans refinanced upon the conclusion of senior financing;
- refinancing the equity made available upfront; and
- in select cases, functioning even as senior lender.

The mix of available financing instruments is sometimes accompanied by project bonds or other sources of financings, such as export credit agency financings.

8.7 Natural Resources

Ownership of land as such does not require a licence, and resources found on the property generally belong to the owner. Nonetheless, the extraction of metals, salt and similar resources requires authorisation from the mining authority. Likewise, the establishment and operation of energy pipelines, electrical transmission lines and related infrastructure must receive approval from the relevant authority of the relevant federal state in which the assets are located.

Usually, the granted permit will be time-limited and subject to a number of conditions, such as compliance with environmental, health and safety laws. Royalties, taxes and other fees payable in connection with the extraction of natural resources vary depending on the type of natural resource. There are no general limitations, charges or taxes associated with the exportation of natural resources. However, specific regulations may be applicable to particular exports contingent on the nature of the natural resource in question.

8.8 Environmental, Health and Safety Laws

As a general rule, projects with the potential to cause adverse environmental impacts or pose hazards to the environment or individuals necessitate a permit, typically obtained from the relevant local authority. The execution of such projects is subject to various regulations, including occupational health and safety guidelines, which are overseen by multiple authorities.

The authority over specific projects varies based on the sector in question. For instance, regulatory oversight for projects in the oil and gas sector rests with regional authorities. The process for oil and gas exploitation in Germany follows a two-step approach, requiring an initial permit for exploration and a separate one for actual extraction. In the case of offshore wind farms, an operating permit issued by the Federal Maritime and Hydrographic Agency of Germany is mandatory, while the energy grid is managed by the Federal Network Agency (*Bundesnetzagentur*).

CHAMBERS GLOBAL PRACTICE GUIDES

Chambers Global Practice Guides bring you up-to-date, expert legal commentary on the main practice areas from around the globe. Focusing on the practical legal issues affecting businesses, the guides enable readers to compare legislation and procedure and read trend forecasts from legal experts from across key jurisdictions.

To find out more information about how we select contributors, email Katie.Burrington@chambers.com