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Germany facilitates Refinancing and Credit Portfolio Transactions

- New Ruling on the Enforcement of Assigned Land Charges -

Introduction

Corporate real estate transactions are, more often than not, financed not only through equity but also by taking out a loan from a bank, at least to a certain extent. This is because either the acquiror's available liquidity is not sufficient to cover the purchase price or because the acquiror wants to make use of the leverage effect to be gained by third party financing. Be that as it may, the lender will always require appropriate collateral. It goes without saying that in real estate financing transactions land charges (*Grundschulden*) play a key role as security instruments. Following registration of the land charge in the land register, the secured creditor, i.e. the bank, is then in a position, should it come to enforcing the land charge, to levy execution on the real estate which is encumbered with the land charge.

The land charge is created by way of a notarial deed. This deed also typically includes a clause by which the debtor submits itself to immediate execution with respect to the real estate in question as well as to its other property. Such "submission-to-immediate-execution clauses", and in particular their fate in the event that the claim for repayment of the loan and the securing land charge are assigned to a third party, are the topic of this newsletter.

Such assignments of the claim for repayment of the loan and the securing land charge may occur, e.g., in refinancing or credit portfolio transactions. In such cases, naturally, the assignee wants to, if the loan is not paid back when due and if therefore an enforcement event with regard to the land charge arises, make use of the submission-to-immediate-execution clause. A requirement for that under German law is that the assignee has at hand an enforceable counterpart of the land charge deed for the purpose of levying execution. To that end, it is necessary that the notary (who had notarized the land charge deed upon its creation) produce a special execution certificate (*Vollstreckungsklausel*) in favour of the assignee.

Legal situation as heretofore

The legal situation with respect to enforcing assigned land charges was somewhat unclear until recently. The reason therefor was that the *BGH* (*Bundesgerichtshof*), the German Federal Court of Civil Justice, the highest German court in civil matters, had ruled on March 30, 2010 that the notary, when approached by an assignee of the land charge with the request of issuing the execution certificate as described above, was only entitled to do so after having duly verified that the assignee of the land charge had also acceded to the so-called security purpose agreement (*Sicherungsvereinbarung*) as usually entered into between the debtor and the original creditor (*BGH*, judgement of March 30, 2010, XI ZR 200/09). Such security purpose agreements typically contain further arrangements and agreements between debtor and creditor as to the extent of the security granted by the land charge. The *BGH's* reasoning at the time was that the submission-to-immediate-execution clause had to be construed, irrespective of its wording, in a manner such that the assignee of the land charge was only allowed to make use of it for execution purposes if the assignee also had acceded to the security purpose agreement. This was said to be necessary in order to appropriately safeguard the interests of the debtor, i.e. the grantor of the land charge. It, so went the line of thought of the *BGH*, should be in a position to effectively raise all defences against the claim arising out of the land charge it might have against the original creditor also against the assignee.

This judgement of the *BGH* has created significant uncertainty among legal practitioners, in particular among notaries. It was unclear how and by what documents the accession to the security purpose agreement should be evidenced to the satisfaction of the notary. And even in refinancing transactions where the assignment of the land charge typically occurs at the instigation of the debtor (the

safeguarding of whose interests had been a leading motive for the *BGH*) the assignee was facing difficulties: many notaries refused to issue the execution certificate requested by the assignee on the grounds that the fact that the assignment occurred at the instigation of the debtor could not be evidenced by way of certified documents.

The new decision of the *BGH*

Recently, the *BGH* has clarified the situation. The court (*BGH*, judgement of June 29, 2011, VII ZB 89/10) now says that the notary to whom the assignee of a land charge turns with the request of issuing an execution certificate, is, as a rule, authorized to issue such certificate without verifying that the assignee has acceded to the security purpose agreement. An exception to this rule shall only apply if the submission-to-immediate-execution clause should include at least some language, however rudimentary it may be, pointing into the direction of the interpretation that the parties wanted to require a possible assignee to accede to the security purpose agreement prior to being able to enforcing the land charge. But, so says the *BGH* expressly, if there is no such language in the land charge deed, the notary must only verify the legal title of the assignee, i.e., his successorship to the assignor, but is not required to consider any further unwritten prerequisites. And with regard to safeguarding the interests of the debtor, the *BGH* rightly points out that the debtor is sufficiently equipped against unjustified executions by the assignee by way of the special action as provided for in the German Code of Civil Procedure (sec. 768 *ZPO*) which entitles it to bring suit against the issuing of the execution certificate and to raise all defences it may have in this suit.

Conclusion

The new decision of the *BGH* brings greater clarity in the event of assignments of land charges and subsequent requests by the assignee to the notary to issue execution certificates. The notary is now, as a rule, not required to be provided with evidence on the assignee having acceded to the security purpose agreement relating to the assigned land charge. This is good. Refinancing and credit portfolio deals and all other transactions involving the assignment of land changes are made easier.

If you have questions on the foregoing, please contact Klaus J. Müller (mueller@schiedermair.com) or one of the other notaries of our firm. Please note that the information contained in this newsletter is not meant to replace legal counsel. You should seek specific advice before taking any action with regard to the matters discussed above. All of our newsletters are available at www.schiedermair.com.