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Chapter 20

Germany

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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the debtor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable "contract" be deemed to exist as a result of historic relationships?

Under German law, it is not necessary for the creation of an enforceable debt obligation of the debtor that a sale of goods or the provision of services be evidenced by a formal receivables contract. It is sufficient if the parties agree orally on the sale of goods or the provision of services, or if the respective agreement is deemed to exist due to the facts and circumstances, including as a result of historic relationships. Of course, in such cases it may be difficult to prove the scope of the sale or the services concerned, as well as the consideration payable therefor. An invoice alone, if not backed by a formal or informal receivables contract, would not be sufficient to create an enforceable debt obligation.

1.2 Consumer Protections. Do your country's laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; or (c) provide other noteworthy rights to consumers with respect to receivables owing by them?

There are no German laws that would specifically regulate permissible rates of interest on consumer credit, loans or other kinds of receivables. Under a general provision in the German Civil Code, however, a receivables contract that provides for a usurious rate of interest can be void. According to German case law, as a rule of thumb, the applicable limit in this regard is twice the market rate or, in periods of particularly high market rates, around 12% *p.a.* above the market rate. The application of the referenced code provision will, however, always be driven by the facts and circumstances.

If the debtor is in arrears (*Verzug*) in discharging the receivable of the seller, German statutory law provides that the receivable bears interest at the base interest rate (*Basiszinssatz*) published by Deutsche Bundesbank plus 5% *p.a.* or, if the debtor is not a consumer, 8% *p.a.* A debtor would generally be in arrears if it does not make payment when due and (i) the payment was due on a specified date; (ii) the debtor has, after the payment became due, received a payment reminder (*Mahnung*); or (iii) the debtor has received an invoice and does not make payment within thirty days of the due date and the receipt of such invoice.

For loans to consumers (and transactions, such as hire-purchase transactions, that are closely linked to consumer loans), German law provides for special rules that are designed to protect borrower consumers. In order to be enforceable in accordance with their terms, any such loan agreements have to contain certain information on the loan (which should help the consumer to assess his or her future payment obligations) and need to be in writing. In addition, the debtor is entitled to rescind the loan agreement within two weeks from its execution.

Other consumer protection laws become relevant in respect of contracts entered into at the place of abode of the debtor and contracts comprising standard business terms.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency are there different requirements and laws that apply to the sale of receivables?

Where the government or its agencies enter into receivables contracts for general commercial purposes, no special rules apply to the sale or assignment of such receivables, except that any such assignment is valid even where there is a contractual prohibition on assignments (*see* question 4.5 below). Special assignment restrictions and notice requirements apply to tax reimbursement and similar claims. In securitisation transactions, due to enforceability concerns, it is generally agreed that receivables against government agencies are ineligible.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the debtor do not specify a choice of law in their receivables contract, what are the main principles in your country that will determine the governing law of the contract?

As a general rule, under German conflict of laws principles, in the absence of any (explicit or implicit) choice of law by the parties to the receivables contract, the laws of the country to which such receivables contract has the closest link govern the receivables contract. In this context, the conflicts rules contain several rebuttable presumptions, including to the effect that the closest link is generally considered to exist with that jurisdiction where the contractual party that has to perform the characteristic obligations under the contract (in connection with a receivables contract, this is generally the seller or service provider) is established.

2.2 Base Case. If the seller and the debtors are resident in your country, and the transactions giving rise to the receivables and the payment of the receivables take place in your country, and the seller and the debtor choose the law of your jurisdiction to govern the receivables contract, is there any reason why a court in your country would not give effect to their choice of law?

No. A German court would give effect to the parties' choice of law.

2.3 Freedom to Choose Other Law. If the seller and the debtors are resident in your country, and the transactions giving rise to the receivables and the payment of the receivables take place in your country, can the seller and the debtor choose a different country's law to govern the receivables contract and the receivables?

As a general rule, German conflict of laws principles permit the parties to a receivables contract to choose the law governing that contract. Such a choice of law can be express or implied. A choice of law provision can also be added or modified after the original contract was entered into.

However, where a receivables contract is exclusively connected with a single jurisdiction (taking into account, in particular, the identity of the parties and the place of performance), German courts apply to the contract the mandatory provisions of the laws applicable in that jurisdiction, irrespective of the choice of law. In addition, certain provisions of German law that are considered "internationally mandatory" cannot be validly derogated from. Furthermore, in a consumer contract for the delivery of goods or the provision of services, or for a related financing transaction, the seller and the debtor cannot disapply consumer protection laws that are mandatory in the jurisdiction of the consumer's customary abode if the contract has connections with such jurisdiction besides the consumer's abode. Finally, any contractual choice of law is subject to the German *ordre public*.

2.4 Seller Resident. If the seller is resident in your country, and the seller and the debtor choose the law of your country to govern their receivables contract, will a court in your country give effect to their choice of law?

Subject to the rules described in question 2.3 above, a German court would give effect to the parties' choice of law.

2.5 Debtor Resident. If the debtor is resident in your country, and the seller and the debtor choose the law of your country to govern their receivables contract, will a court in your country give effect to their choice of law?

Subject to the rules described in question 2.3 above, a German court would give effect to the parties' choice of law.

3 Choice of Law - Receivables Purchase Agreement

3.1 Freedom to Choose Other Law. If your country's law governs the receivables, and the seller sells the receivables to a purchaser in another country, and the seller and the purchaser choose the law of the purchaser's country or a third country to govern their sale agreement, will a court in your country give effect to their choice of law?

Subject to the rules described in question 2.3 above and question 3.3 below, the parties are free to choose the law of the purchaser's country or a third country to govern their sale agreement.

3.2 Other Advantages. Conversely, if another country's law governs the receivables, and the seller is resident in your country, are there circumstances where it would be beneficial to choose the law of your country to govern the sale agreement?

It would generally not be beneficial to choose German law to govern the sale agreement if the seller is resident in Germany and another country's law governs the receivables. *See* also question 3.3 below.

3.3 Effectiveness. In either of the cases described in questions 3.1 or 3.2, will your country's laws apply to determine (i) whether the sale of receivables is effective as between the seller and the purchaser; (ii) whether the sale is perfected; and/or (iii) whether the sale is effective and enforceable against the debtors?

German law and German conflicts principles distinguish between the contractual undertaking to assign a receivable (*i.e.*, the sale) and the actual assignment *in rem* (*i.e.*, the performance of such undertaking). As between the seller and the purchaser, the principles described in question 2.3 above apply to a contractual choice of law relating to the undertaking to assign, *i.e.*, the law governing the receivable is not applied to determine the effectiveness of such undertaking where the law of another jurisdiction was validly chosen to govern the agreement. However, German courts would apply the law governing the receivable to determine the effectiveness of its assignment *in rem* as between the seller and the purchaser as well as the debtors.

4 Asset Sales

4.1 Sale Methods Generally. In your country what is (are) the customary method(s) for a seller to sell accounts receivables to a purchaser?

Although not legally required, for evidentiary purposes, accounts receivable are generally sold and transferred under written sale and transfer agreements entered into between the seller and the purchaser.

4.2 Perfection Generally. What formalities are required generally for the sale of accounts receivable to be perfected? Are there any additional or other formalities required for the sale of accounts receivable to be perfected against any subsequent good faith purchasers for value of the same accounts receivable from the seller?

Under German law, generally, the only requirement for an effective sale and assignment of accounts receivable is the existence of a corresponding agreement between the seller and the purchaser. Giving notice of the assignment to the debtor is not required for the effectiveness of the sale and assignment. However, failure to give notice to the debtor results in the debtor retaining certain defences as described in question 4.4 below. Under German law, generally, there is no good faith acquisition of accounts receivable.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

In Germany, debt certificates (*Schuldscheine*) are frequently used instruments that are similar to promissory notes in other jurisdictions. Debt certificates, which evidence loan obligations, are not securities. No additional requirements apply to the assignment of debt certificates, although in practice the purchaser requires the seller to hand these over in connection with an assignment of the related loan.

Mortgage loans in Germany can take several forms. Liens on German real property can be granted in the form of an accessory mortgage (*Hypothek*) or a non-accessory land charge (*Grundschuld*). Both can be either in certificated or non-certificated form. A mortgage is accessory in that it cannot be transferred without the receivable that it secures, and that it is automatically transferred if such receivable is transferred. The assignment of a loan that is secured by a mortgage requires a written assignment of the loan and (i) in the case of a certificated mortgage, delivery of the mortgage certificate; or (ii) in the case of a non-certificated mortgage, registration of the transfer with the competent land register. A loan secured by a land charge can be assigned without the land charge, by way of a simple agreement between the seller and the purchaser. If the land charge is to be transferred as well, such transfer has to be by written assignment of the land charge and delivery of the certificate or registration of the transfer, as applicable.

Transferring un-certificated mortgages and land charges (which make up the vast majority of mortgages and land charges in Germany) can, depending upon the values involved, trigger significant costs in connection with the required registration with the land register. In many cases sellers express an interest in avoiding registration of the transfer in order to avoid having the debtor obtain knowledge of the assignment. For this purpose, the parties frequently agree that the seller shall hold the land charge as trustee for the purchaser. (This is not possible in the case of a mortgage.) However, it is unclear under German law whether such a trust relationship would be recognised in the insolvency of the seller, *i.e.*, whether the purchaser would be entitled to request the seller's insolvency official to transfer the land charge.

In September 2005, the German Banking Act was amended to provide for, among other things, so-called "refinancing registers" (*Refinanzierungsregister*) to be maintained by banks in respect of receivables, including mortgages or land charges securing such receivables that such bank or a third party owns but is obligated to transfer to a securitisation vehicle. Effectively, without a true sale being effected at the outset of the transaction, such registration provides the purchaser with the same right to segregate the assets concerned from the seller's insolvency estate (thereby addressing the issues described above) as would apply if a true sale had occurred.

No special rules apply to the sale and assignment of consumer loans.

Additional requirements relating to the sale of debt securities under German law depend upon the type of securities involved. The transfer of bearer securities requires an agreement between the seller and the purchaser to transfer ownership and the delivery of the securities to the purchaser. Registered securities are transferred by way of assignment of the rights that they evidence. Instruments made out to order are transferred by way of agreement between the seller and the purchaser to transfer ownership, endorsement and delivery of the instrument to the purchaser. Where debt securities are certificated in global form and deposited with a clearing system, delivery of the securities is evidenced by way of book-entry. Where debt securities are in un-certificated form (such as debt securities issued by the German federal government), the transfer requires registration with the relevant register.

4.4 Debtor Notification. Must the seller or the purchaser notify debtors of the sale of receivables in order for the sale to be an effective sale against the debtors?

Under German law, giving notice to the debtor is not required for an effective sale and assignment of a receivable, unless required by the receivables contract (*see* question 4.5 below). The purchaser is generally entitled to enforce the receivable directly against the debtor (providing required evidence of the assignment), whether or not the debtor was previously notified of the sale and assignment. However, the debtor may generally invoke against the purchaser all defences that it had against the seller at the time of the assignment.

Unless the debtor has been notified or has otherwise obtained knowledge of the assignment, it may validly discharge its obligation by making a payment to the seller, and the purchaser is bound by any amendment to the receivables contract agreed by the seller and the debtor. The same applies if the seller and the debtor enter into any other transaction relating to the receivable, such as a waiver of the receivable by the seller or a deferral of payments.

In addition, the debtor continues to be able to discharge its obligation under the assigned receivable by offsetting it against a payable of the seller unless (i) the debtor knew of the assignment when it acquired the payable; or (ii) the payable becomes due only after the debtor has obtained knowledge of the assignment *and* after the assigned receivable has become due. In other words, even if the debtor has obtained knowledge of the assignment, it may continue to offset the assigned receivable against a payable of the seller if (i) it acquired the payable before it obtained such knowledge; or (ii) the payable has become due before the receivable becomes due.

4.5 Debtor Consent. Must the seller or the purchaser obtain the debtors' consent to the sale of receivables in order for the sale to be an effective sale against the debtors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment?

As a general rule, a receivable that is governed by German law can be freely sold and assigned without the debtor's consent if the underlying agreement does not contain any prohibition on assignments.

Until recently, it has been disputed among German courts and commentators whether an exception to this rule should apply where the assignment of a receivable owed by an individual is in violation of German data protection laws. However, in February 2007, the German Supreme Court held (in line with the previous majority view) that a violation of data protection laws does not render the assignment of a receivable void. It should be noted that it is not fully clear whether this would be equally applied to an assignment of receivables involving the transfer of data whose confidentiality is protected by German criminal law (*e.g.*, in respect of a doctor's patient data, in respect of which a 2005 Court of Appeals decision considered an assignment void).

A prohibition on assignments can also be implied in a receivables contract. It had been argued (including in a 2005 decision of the Frankfurt Court of Appeals that created significant uncertainty in the market) that the general contractual bank secrecy obligation to which every German bank is subject vis-à-vis its customers (*see* question 8.2 below) resulted in such an implied prohibition on assignments, at

least as long as the customer was performing its obligations. In its aforementioned decision of February 2007, however, the German Supreme Court held that contractual bank secrecy obligations do not result in an implied restriction on assignments.

Where a receivables contract contains a prohibition on assignments, the seller can still sell (*i.e.*, undertake to assign) the receivable, but it cannot effect a valid assignment *in rem*. The seller is liable for any damages incurred by the debtor in connection with an assignment that failed on this basis.

As an exception to the foregoing rule, a seller can validly assign a receivable in spite of a contractual prohibition on assignments where both the seller and the debtor are corporate entities, partnerships or individual merchants and the receivables contract constitutes a commercial transaction, or where the debtor is a government agency. However, it is not fully clear whether any such assignment constitutes a breach of contract that can result in liability for damages or for the payment of any contractual penalty. In any event, in such a case the debtor can still discharge the receivable by making a payment to the seller (or by way of set-off), even where the debtor has been notified of the assignment. The resulting risks, which can be eliminated only by obtaining the debtor's consent, generally lead rating agencies to conclude that the highest rating categories cannot be applied where the true sale of an assignment is based upon this exception.

4.6 Liability to Debtor. If the seller sells receivables to the purchaser even though the receivables contract expressly prohibits assignment, will the seller be liable to the debtor for breach of contract?

As described in question 4.5 above, this is not fully clear in respect of commercial transactions among merchants and receivables against government agencies. Otherwise, any such sale would generally constitute a breach of contract that may give rise to liability for damages, but the latter would require the debtor to show that it incurred financial damage due to the sale.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., debtor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics?

It is not necessary to specifically identify each of the receivables to be sold in order to provide an effective sale and assignment of German law-governed receivables. It is sufficient if the receivables are identifiable, *e.g.*, by reference to the initial letters of the debtor names.

4.8 Economic Effects on Sale. What economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; and (c) control of collections of receivables without jeopardising perfection?

The economic characteristics have no bearing under German law as to whether the sale is being "perfected". However, such characteristics could be relevant for determining whether the sold receivables no longer form part of the seller's insolvency estate, or whether the transaction must be recharacterised as a secured loan. Given that there is no case law on point and limited other guidance in published form in this respect, the exact circumstances in which a purported sale must be re-characterised as a secured loan are not fully clear.

The general view in the market is as follows. Any true sale of receivables requires an effective assignment of legal ownership as described in question 4.2 above. In connection with any such assignment, the mere retention by the seller of the risk that the receivables exist and are legal, valid, binding and enforceable does not result in the true sale character of the transaction being jeopardised, and neither does the continued servicing of the receivables by the seller. The possible re-characterisation of the transaction rests, in particular, on the seller's retaining an excessive portion of the credit risk from the receivables sold, including through representations and warranties, repurchase obligations/automatic re-assignments, variable purchase prices, liquidity/credit enhancement provided by or on behalf of the seller or the acquisition by the seller of a first loss tranche of the securities issued. The seller may retain some portion of the credit risk in line with historical default rates and taking into account enforcement costs.

Where the sale of receivables is re-characterised as a secured loan for insolvency law purposes, upon the opening of a German insolvency proceeding with respect to the seller, the seller's insolvency official and not the purchaser is entitled to collect the receivables. In addition, the insolvency official is entitled to retain from the collection proceeds a flat fee (haircut) of, generally, 9% for the benefit of the insolvency estate. The amount of this fee may be adjusted where the actual enforcement costs are significantly higher or lower. A 4% fee applies where the insolvency official permits the purchaser to collect the receivables. Upon a collection by the insolvency official, the collection proceeds (after deduction of these fees) are to be transferred to the purchaser. As a practical matter, secured creditors frequently enter into agreements with insolvency officials providing for higher haircuts.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables?

Yes. As a technical matter, in factoring or securitisation transactions involving periodic sales and transfers of receivables, the seller and the purchaser generally enter into a framework agreement that governs the terms and conditions for each future sale and transfer of receivables. The actual sale and transfer in respect of individual receivables is then effected on the basis of an exchange of data on the transferred receivables by which the latter are identified. However, such arrangements would not prevail in an insolvency of the seller for sales not consummated prior to the insolvency. *See* also question 6.5.

4.10 Future Receivables. Can the seller commit in an enforceable manner (both prior to and after its insolvency) to sell receivables to the purchaser that come into existence after the date of the sale contract (as in a "future flow" securitisation)?

Under German law, it is possible to sell and assign receivables arising in the future, provided that such receivables are sufficiently identified (or at least identifiable, *see* question 4.7 above). The purchaser then obtains ownership of such receivables at the time when they arise, unless at such time other prerequisites of a valid assignment have ceased to exist, in which case the assignment fails. The latter applies, in particular, where an insolvency proceeding has been opened with respect to the seller prior to the receivable coming into existence, because in such a case the seller is no longer able to dispose of its assets.

It should be noted that, in certain circumstances, it is difficult to

determine whether a receivable is in fact a "future" receivable to which these rules apply (such as a claim for future rental payments) or an existing receivable that is not yet due (such as the repayment claim under a loan agreement). *See* also question 6.5.

4.11 Related Security. What additional formalities must be fulfilled for the concurrent transfer of related security to be enforceable? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

See question 4.3 above in respect of transferring collateral of the type of instruments described therein. Related security consisting of receivables assigned by way of security assignment (*Sicherungsabtretung*) as well as guarantees (*Garantien*) is transferred by way of security assignment, requiring an agreement between the seller and the purchaser to assign the relevant security. Insurance claims are also assigned, usually requiring notification to, and sometimes the prior consent of, the insurer. If the collateral comprises security over inventory and other movable assets in the form of a security transfer (*Sicherungsübereignung*), the purchaser needs to obtain (indirect) possession of the inventory concerned. If the sold receivable is secured by a pledge (*Pfandrecht*) or surety (*Bürgschaft*), no additional arrangements are necessary to transfer such collateral.

See also question 5.3 below.

5 Security Interests

5.1 Back-up Security. Is it customary in your country to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

No it is not customary.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of your country, and for such security interest to be perfected?

N/A (*see* question 5.1 above).

5.3 Purchaser Security. What are the formalities for the purchaser granting a security interest in receivables and related security under the laws of your country, and for such security interest to be perfected?

Under German law, a security interest in a receivable or related security can be granted in the form of a formal pledge or a security assignment.

To become effective, a formal pledge of a receivable (including guarantees) requires the execution of a pledge agreement and the notification of the debtor. A security assignment, which results in the transfer of legal ownership of the receivables concerned, subject to the assignee's undertaking to foreclose only upon a default and to re-assign the receivables to the assignor upon the performance in full of the secured obligations, becomes effective on the basis of the same requirements as described above in respect of assignments of receivables generally. Accordingly, a security assignment does not require notification of the debtor. (However, failure to notify results in the debtor retaining set-off rights and other defences as described in question 4.4 above.) Due to the fact that assignors frequently seek to avoid such notification, security assignments are far more common than formal pledges of receivables. Exceptions to this rule apply where the notification of the debtor is not an issue, including in respect of inter-company receivables and bank accounts. There have been a few German securitisation transactions that have relied on pledges of receivables, but this continues to be a very uncommon form of security in Germany.

Security over inventory and other movable assets is usually granted in the form of a security transfer because a formal pledge would require the pledgee to obtain actual possession of the assets, whereas indirect possession is sufficient for a security transfer. For security over the types of instruments described in question 4.3. The additional requirements described therein generally also apply to the grant of security over such types of instruments.

See also question 4.11 above.

5.4 Recognition. If the purchaser grants a security interest in the receivables under the laws of the purchaser's country or a third country, and that security interest is valid and perfected under the laws of that other country, will it be treated as valid and perfected in your country?

Due to the fact that both a formal pledge and a security assignment of receivables constitute transactions *in rem*, the same conflict of laws rules described in question 3.3 above in respect of assignments of receivables generally apply to the grant of security over receivables as well. Accordingly, in order to determine whether security over a receivable was validly granted, German courts apply the same law that governs the receivable, irrespective of any choice of law provision to the contrary. Where security was validly granted pursuant to such law, it is generally respected and given effect in Germany. Where security over receivables would be considered valid and perfected under the law chosen by the parties to the security agreement, but not under the law that governs the receivables, German courts do not recognise the security interest.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to promissory notes, mortgage loans, consumer loans or marketable debt securities?

Security over promissory notes, mortgage loans, consumer loans and marketable debt securities can also be created in the form of a formal pledge or by way of security assignment. (In the case of debt securities, the most common form of security is a formal pledge.) As a general matter, the additional requirements described in question 4.3 above also apply to the grant of security over these types of instruments.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will your country's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables ("automatic stay")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected?

Before rendering a decision on whether or not to open a formal insolvency proceeding and appoint an insolvency official, German

insolvency courts frequently appoint a so-called "preliminary insolvency official" for the time period (generally one to three months) during which they asses whether the insolvent company's assets cover the costs of the insolvency proceeding. As a general matter, there is no "automatic stay" on the purchaser's right to collect, transfer and otherwise exercise ownership rights over receivables that were sold to it, neither before nor after the opening of an insolvency proceeding. For so long as only a "preliminary insolvency official" has been appointed, this applies without regard to whether there was a true sale or whether the transaction is to be re-characterised as a secured loan. After the opening of an insolvency proceeding with respect to the seller, the purchaser continues to be so entitled only if the transaction constituted a true sale. Where the transaction is re-characterised as a secured loan, the assignment *in rem* of the receivables is regarded as a security assignment, which results in the insolvency official, rather than the purchaser, being entitled to collect the receivables concerned (and to deduct a haircut from the collection proceeds, all as described in question 4.8 above). *See* also question 6.2 below.

6.2 Insolvency Official's Powers. If there is no automatic stay, under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

Under current law, neither an insolvency court nor an insolvency official has the power to issue an injunction, stay order or other action prohibiting the purchaser from collecting or transferring the receivables concerned for so long as only a "preliminary insolvency official" has been appointed, although some insolvency courts have in fact issued orders prohibiting security assignees from collecting the receivables and ordering the "preliminary insolvency official" to conduct the collection activity. Such court orders are not appealable by the affected creditors.

Becoming effective in July 2007, the German insolvency laws were amended, giving insolvency courts the right to issue, in certain circumstances, an order permitting a "preliminary insolvency official" to collect receivables that were assigned by way of security. As per the wording of the relevant provision, it is not inconceivable that an insolvency court could even prohibit the purchaser in a true sale transaction from collecting the receivables until the opening of an insolvency proceeding. It has to be seen whether the market will consider this risk as material in this context.

Upon the opening of an insolvency proceeding with respect to the seller, no injunctions, stay orders or similar court orders may be issued where there was a true sale, and there is no need for any such orders (because the insolvency official in any event has the exclusive right to collect) where the transaction is re-characterised as a secured loan. However, as a practical matter, where the insolvency official seeks to determine whether the transaction constituted a true sale or has to be re-characterised as a secured loan and meanwhile prevent the purchaser from collecting the receivables, the insolvency official will simply notify the debtors accordingly. This generally has the effect that debtors cease making payments.

6.3 Suspect Period. Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding?

Upon the opening of an insolvency proceeding in Germany, the insolvency official is entitled to rescind acts of the seller (including assignments of receivables) that prejudice third party creditors, provided that certain additional requirements are met. These requirements are set out in statutory rules. German insolvency courts do not have the same discretion in this respect that insolvency courts have in other jurisdictions. Preference periods range from one month to ten years prior to the filing of the application for the opening of the insolvency proceeding. Preference risks are particularly relevant for legal acts taken within three months prior to filing. A ten-year period applies where there was intent to prejudice third party creditors.

Where the assignment of receivables constitutes a so-called "cash transaction" (*Bargeschäft*), the insolvency official is entitled to rescind the transaction only if can be shown (i) that the assignment was effected with an intention to prejudice creditors and the purchaser knew of that intention; or (ii) if the purchaser was not entitled to the receivables assigned. An assignment of receivables generally constitutes a "cash transaction" if the seller, at or about the same time as the assignment was effected, received adequate consideration therefor. In this respect, depending on the type of receivables involved, an assignment may qualify as a "cash transaction" even where the purchase price paid reflects some discount from the nominal value of the assigned receivables. A large discount, a significant time lag between assignment and payment of the consideration, or a deferred purchase price arrangement, however, disqualify the transaction as a "cash transaction".

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

German insolvency law does not contemplate the substantive consolidation of assets and liabilities of sellers and purchasers or their affiliates. Under general corporate law principles, there may be liability under piercing the corporate veil principles, but this does not result in any consolidation of assets and liabilities.

6.5 Effect of Proceedings on Future Receivables. What is the effect of the initiation of insolvency proceedings on (a) sales of receivables that have not yet occurred or (b) on sales of receivables that have not yet come into existence?

German insolvency law gives an insolvency official the right to elect whether to perform or reject performance of executory contracts, *i.e.*, contracts that have not been fully performed by at least one party. The application of this general rule affects future sales of receivables as well as mutually unperformed contracts underlying the (existing) receivables sold and the assignment of receivables that have not yet come into existence (*i.e.*, future receivables). Where the insolvency official's election right does not apply in respect of a contract underlying receivables, the contract concerned continues to bind the insolvency estate and the counterparty, but as explained below this does not always result in the enforceability of the sale and assignment of resulting receivables.

The receivables purchase agreement itself may be subject to the insolvency official's election right if the agreement has not been fully performed by at least one party, in particular if it addresses future sales. If properly drafted, however, receivables purchase agreements pertaining to term deals are generally not subject to the election right because the seller (by assigning the receivables) has fully performed its relevant obligations. In the case of a receivables purchase agreement in a revolving securitisation transaction which

provides for a series of sales under a single master agreement, any election by the insolvency official to reject performance may also pertain to sales that were consummated in the past. To avoid this risk, each sale under the master agreement must be structured as an independent transaction.

In the case of mutually unperformed contracts underlying the receivables sold, where the insolvency official has an election right and elects performance, any future payments by the debtors are due to the insolvency estate, not to the purchaser. Where the insolvency official elects to reject performance, the receivables do not become due at all. Consequently, unless the cash flows required to service the asset-backed securities are otherwise ensured, a successful securitisation generally requires that the insolvency official's election right does not apply to the underlying receivables contracts. In addition, an assignment of "future receivables" that come into existence after the opening of the insolvency proceeding (as opposed to the assignment of previously existing receivables that become due after the opening of the insolvency proceeding) is not enforceable.

- Upon the insolvency of the seller/lessor, leases and leasing contracts pertaining to movables are not subject to the insolvency official's election right if the acquisition of the leased objects was financed by a third party and that third party has obtained security in the form of a security transfer of the leased objects. (Legal uncertainty exists in this regard where the lessor is not identical to the owner of the leased objects, which is not uncommon in the German leasing market.) It is a question of the applicable facts and circumstances (*i.e.*, in particular the terms of the applicable lease or leasing contract) whether the receivables under such contracts are, for German insolvency law purposes, "future receivables". In general, instalments due under so-called "financial leasing" contracts are considered not to constitute "future receivables", but to come into existence upon the conclusion of the leasing agreement and to become due from time to time.
- Leases pertaining to real estate are not subject to the insolvency official's election right but may be terminated by the insolvency official (subject to statutory notice periods) irrespective of the agreed term of the lease. Furthermore, lease receivables under real estate leases constitute "future receivables" and cannot be validly assigned with effect for the seller's/lessor's insolvency estate to the extent that they pertain to the period after the month in which the insolvency proceeding is opened (or, if the opening date is later than the 15th day of a month, the next following month). Nevertheless, any such lease receivables can be (and customarily are) covered by a mortgage or land charge over the relevant real estate that can be enforced by the mortgagee in the seller's/lessor's insolvency.

By contrast, as regards the securitisation of fully disbursed bank loans, the insolvency official's election right does not apply, given that the relevant loan agreements no longer constitute executory contracts. (Under current law, this has not been entirely free from doubt. However, in line with the predominant view in the market, this will be confirmed, with effect as of July 2007, by the insolvency law amendments referred to in question 6.2 above.) Also, receivables becoming payable from time to time under a bank loan do not constitute "future receivables".

7 Special Rules

7.1 Securitisation Law. Does your country have laws specifically providing for securitisation transactions? If so, what are the basics?

Germany has no laws containing a comprehensive set of rules applicable to securitisation transactions. However, certain typical aspects of securitisations were addressed by recent amendments to existing statutes in several legal areas.

7.2 Securitisation Entities. Does your country have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to (a) requirements for establishment of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Germany does not have any such laws. It should be noted that until a few years ago no German entities were used as purchaser vehicles in securitisation transactions. This has mainly been due to the trade tax issue described in question 9.6 below. Following the introduction, in 2003, of a trade tax exemption for certain purchaser vehicles in bank loan securitisation transactions, there have been a number of transactions involving German purchaser vehicles, including transactions under the German True Sale Initiative.

7.3 Non-Recourse Clause. Will a court in your country give effect to a contractual provision (even if the contract's governing law is the law of another country) limiting the recourse of parties to available funds?

See question 7.4.

7.4 Non-Petition Clause. Will a court in your country give effect to a contractual provision (even if the contract's governing law is the law of another country) prohibiting the parties from (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

The predominant view is that such non-recourse clauses and non-petition clauses are valid and enforceable under German law, except to the extent that the relevant underlying claim is based upon the SPE's wilful misconduct or gross negligence. But *see* question 7.5 regarding the obligation of the management of certain types of companies organised under German law to file for insolvency upon illiquidity or over-indebtedness.

7.5 Independent Director. Will a court in your country give effect to a contractual provision (even if the contract's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

In the case of German SPEs (which are generally in the form of limited liability companies (*GmbH*)), such a provision would be generally given effect. However, the statutory obligation to file for the opening of an insolvency proceeding where the company is either unable to pay its debts as they become due or over-indebted, and the incurrence by management of personal liability for damages and criminal liability upon a breach of such obligation, would remain unaffected by any non-petition clause in the transaction documents or the GmbH's organisational documents.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in your country, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any license or its being subject to regulation as a financial institution in your country? Does the answer to the preceding question change if the purchaser does business with other sellers in your country?

The general view in the market is that, as a securitisation transaction does not involve the transfer of any undrawn commitments, the purchase and ownership of receivables by the purchaser, and its collection and enforcement of receivables owned by itself, do not trigger any licensing requirements in Germany. However, where the sold receivables are serviced by a third party on behalf of the purchaser, such party must have a collection licence under the German Act on Rendering Legal Services. An exception to the licensing requirement applies where a seller continues to service sold receivables that were originated by itself. Consequently, as a practical matter, this licensing requirement becomes relevant only in the case of a transfer of the servicing to a back-up servicer. In addition, any servicer must comply with German data protection laws.

8.2 Data Protection. Does your country have laws restricting the use or dissemination of data about or provided by debtors? If so, do these laws apply only to consumer debtors or also to enterprises?

Germany has data protection laws, the most important of which is the Federal Data Protection Act, that restrict the use and dissemination of data about or provided by debtors. This law applies only to personal data relating to debtors that are individuals (including individuals in their capacity as merchants) and, in the view of some commentators, partnerships that have individuals as partners. The law provides that, where the affected individual has not consented to the transfer of personal data, such transfer is permissible only if the transferor's interest in transferring the data outweighs the affected individual's interest in avoiding such transfer. The predominant view is that, in a typically structured securitisation transaction, this analysis generally results in the permissibility of the transfer of data. The argument in favour of this conclusion is even stronger where a securitisation transaction is structured so that it involves a data trustee as referred to in the German bank regulator's securitisation release described below (which is, however, not always the case where non-bank assets are being sold).

Independently of data protection laws, banks are subject to bank secrecy restrictions vis-à-vis their customers (individual or other customers). These restrictions are considered to be of contractual nature. The standard business terms of German banks generally address these expressly, but even where there is no such express provision, German courts consider the banks to be bound by an implicit restriction. In 1997, the German bank regulator issued a release on the securitisation of German bank assets, which also addressed bank secrecy requirements. The regulator took the position that bank secrecy is complied with as long as the seller bank continues to service the bank loans, because no transfer of debtor-related information to the purchaser is required. Where a back-up servicer is appointed, the regulator requires it to be a credit institution based within the EU or the European Economic Area. In any event, the regulator considers disclosure of information permissible (i) to the extent required for an effective assignment, if the purchaser receives debtor-related information in anonymised form, with the complete set of information being deposited with a neutral qualifying data trustee; and (ii) to the extent that information is "strictly technically required" to be passed on, and passed on in anonymised form, to third parties (such as rating agencies, auditing firms or trustees) that are also bound by a confidentiality obligation. Although the views expressed by the German bank regulator are not binding upon German courts, they are generally considered to be of persuasive value. The general view in the German market is that bank secrecy is not violated in a securitisation transaction that is structured so as to comply with the requirements set out in the 1997 release.

Neither data protection nor bank secrecy is an issue where the debtor has approved the transfer of the relevant data. Such approval may be contained in a general consent to a sale and assignment of receivables for refinancing purposes. Some German banks have recently amended their standard business terms to that effect.

8.3 Consumer Protection. If the debtors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of your country? Briefly, what is required?

As a general rule, only the originator of the receivables (*i.e.*, the seller) is responsible for compliance with German consumer protection laws. Non-compliance may affect the validity of the receivables contracts or give the debtor a rescission right. Consequently, the purchaser needs to review whether the seller has been in compliance with these laws. In addition, it is customary for the seller to give the purchaser corresponding representation and warranties. Consumer protection laws become particularly relevant in respect of loan agreements, receivables contracts entered into at the place of abode of the debtor, and receivables contracts that are based upon the seller's standard business terms.

8.4 Currency Restrictions. Does your country have laws restricting the exchange of your country's currency for other currencies or the making of payments in your country's currency to persons outside the country?

Germany has no such laws (with the exception of those implementing United Nations, EU or other international sanctions in respect of transactions with certain countries and persons). Where a German resident receives from, or makes payments to, non-German residents, the German resident must in certain circumstances notify such payments to Deutsche Bundesbank. However, such notification serves for statistical purposes only, and failure to notify does not affect the payment or the underlying obligation.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the debtors to the seller or the purchaser be subject to withholding taxes in your country? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Payments on receivables (including interest payments) are generally not subject to withholding taxes in Germany. However, certain exceptions may apply depending on the nature of the receivables. For example, interest payments on certain hybrid debt instruments (*i.e.*, participating loans, profit-contingent or

convertible bonds, jouissance rights and silent partnership interests) are subject to withholding at 26.375% when the debtor is resident in Germany for tax purposes (*i.e.*, has its place of residence, effective place of management or statutory seat in Germany).

Furthermore, German tax authorities have the power to instruct a debtor to withhold tax at a rate of 26.375% on payments from German sources to a recipient who is not resident in Germany for tax purposes but is subject to taxation in Germany on its net income from such payments when this appears appropriate so as to safeguard Germany's taxation right. This may apply, for example, to interest payments on loans that are secured by German situs real estate.

Finally, a domestic withholding tax on interest (*Zinsabschlag*) is levied when a bank or financial services institution makes interest payments (*e.g.*, on customer deposits) or passes on interest paid with respect to securities in its capacity as custodian in Germany. However, no such tax is withheld when interest is paid or passed on to a recipient that is itself a bank or financial services institution *or* is not resident in Germany for tax purposes.

When the income on which the tax was withheld is included in the recipient's German income tax assessment, the amount withheld is credited against the recipient's German income tax liability or, if the amount withheld is in excess of such liability, refunded. If the income is not included in such assessment (*e.g.*, because the recipient is not subject to net income tax with respect to such income in Germany), the recipient may nevertheless be able to claim a full or partial refund of the withholding tax under certain circumstances (*e.g.*, because the recipient is eligible for an exemption from, or a reduction in the rate of, such withholding tax under an applicable income tax treaty). The recipients tax assessment system for income from capital investments (including interest income), as described above, may, however, for individuals holding the securities as private assets, be replaced by the envisaged final withholding tax system (*Abgeltungsteuer*), which is scheduled to become effective as of 1 January 2009.

9.2 Seller Tax Accounting. Does your country require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

Germany has not adopted any specific accounting policy for tax purposes in the context of a securitisation. As German tax accounting is always essentially based upon German GAAP, the answer to the question of whether the seller or the purchaser has to show the assigned receivables in its tax balance sheet depends on whether the sale of the receivables can be considered as a true sale for tax accounting purposes, *i.e.*, whether the legal and/or economic ownership in the receivables has been transferred. The treatment under IFRS or US GAAP is not decisive for German tax accounting purposes. IFRS or US GAAP may, however, gain influence on interest deduction issues for German tax purposes in light of the envisaged German business tax reform 2008 (*Unternehmensteuerreform 2008*), which is scheduled to become effective as of 1 January 2008.

9.3 Stamp Duty, etc. Does your country impose stamp duty or other documentary taxes on sales of receivables?

Germany does not impose a stamp duty or other documentary taxes on sales of receivables.

9.4 Value Added Taxes. Does your country impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Germany generally imposes value added tax at a rate of 19% on sales of goods or services. The sale of receivables is exempt from value added tax (but the seller can generally elect to waive this exemption).

In general, Germany also imposes value added tax on fees for collection agent services. In consequence of the decision of the European Court of Justice (ECJ) on 26 June 2003 in MKG-Kraftfahrzeuge-Factoring GmbH, the German tax authorities amended the Value-Added Tax Guidelines, pursuant to which the purchaser of receivables is considered to be rendering taxable collection services (also referred to as "factoring services") to the seller when the purchaser assumes the actual collection of the receivable. The value added tax for such factoring services is generally assessed on the difference between the nominal value of the receivables assigned and the purchase price for such receivables, less the value added tax included in such difference. Special rules apply to determine the assessment basis with respect to distressed receivables.

However, a different analysis applies when the seller continues to collect the receivables after the sale, as is typically the case in securitisation transactions. In this case, the collection of the receivables by the seller is not treated as a separate service to the purchaser, provided that in collecting the receivables, the seller acts in its own interest and on the basis of its own, retained right. Even when the seller's activity is based on a separate agreement, such activity is viewed as a supplementary service to a tax-exempt transaction and therefore the fees for such collection agent services are also exempt from value added tax. The predominant view among market participants is that, due to the rules set out in the aforementioned release, the issues created by the ECJ decision have been resolved for typically structured German securitisation transactions.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims against the purchaser or on the receivables or collections for the unpaid tax?

Pursuant to a provision introduced in 2003 (Section 13c of the Value Added Tax Act), the tax authorities are able to make claims against the purchaser for unpaid value added tax, which the seller was required to pay on a sale of goods or services that gave rise to the receivables. The tax authorities may only make claims against the purchaser to the extent the purchaser collects the receivables. However, the purchaser is deemed to have collected the receivables in full if and to the extent that the purchaser grants a second assignment (or pledge) of the receivables to a third person (including a security assignment or pledge of the purchased receivables to a security trustee). This also applies when the purchaser receives no consideration for this second assignment.

Pursuant to a recent amendment to the Value-Added Tax Guidelines issued by the German tax authorities, the receivables are "deemed to not have been collected by the purchaser" (so that no liability arises) if and to the extent the purchaser pays consideration for the receivables to the unlimited disposition of the seller. Although the language of the Guidelines is somewhat ambiguous in this respect, it is the general view among market participants that the purchaser's second assignment of the receivables to a third party does not

change this result. On this basis, the risk of the purchaser becoming liable for value added tax in a typical securitisation transaction is generally limited to the valued added tax contained in the difference between the nominal amount of the receivables sold and the purchase price delivered by the seller, *e.g.*, due to discounts and cash reserves (*cf.* "*Standard & Poor's Settles its Position on German VAT Question*", published by Standard & Poor's on 30 September 2004).

9.6 Doing Business. Assuming that the purchaser conducts no other business in your country, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the debtors, make it liable to tax in your country?

In general, the purchase of receivables would not make a purchaser that conducts no other business in Germany liable to tax in Germany. Exceptions may apply if the receivables produce income from German sources (as defined in German tax law). In some cases (*e.g.*, interest payments on hybrid debt instruments), the purchaser's liability to tax in Germany is then satisfied through withholding (*see* question 9.1 above). In other cases (*e.g.*, interest payments on loans secured by German situs real estate, with an exception being applicable to bonds and claims which are recorded in a public register or which are represented by global securities or securities representing part of a securities issue (*Teilschuldverschreibungen*)), the purchaser's (corporate) income tax liability is assessed on the basis of its net income from German sources. In many of its income tax treaties Germany waives the right to tax interest on loans secured by German situs real estate. Therefore, a purchaser that is resident in a treaty jurisdiction and eligible for the benefits of such treaty will not be liable to tax in Germany when it purchases receivables producing such income.

The appointment of the seller as the purchaser's service and collection agent, or the purchaser's enforcement of the receivables against the debtors, should not ordinarily make the purchaser liable to tax in Germany. However, the German tax authorities have indicated that they may treat the purchaser as a resident of Germany for tax purposes if the purchaser is an entity that has no substantial presence outside of Germany. In this case, the purchaser may be treated as having its effective place of management in Germany because the seller in its capacity as servicer and collection agent makes the decisions relating to the day-to-day management of the purchaser's business (in particular, the enforcement of the receivables against the debtors) in Germany. As a result, the purchaser would be subject to German (corporate) income tax and trade tax. In light of the decision of the European Court of Justice (ECJ) on 12 September 2006 in Cadbury Schweppes, the German tax authorities issued administrative guidance dealing with the question how much substance a foreign company must be able to show in order to be recognised for German foreign tax act purposes (*Hinzurechnungsbesteuerung*). Although the administrative guidance addresses scenarios different from securitisations, it might put a new focus on substantive presence issues with respect to purchasers.

In this respect, trade tax is typically of particular concern since half of the interest expense on long-term indebtedness is added back to determine trade income. As a result, half of the interest paid by a German resident purchaser to refinance the purchase of the receivables would be subject to trade tax (as opposed to corporate income tax, which is levied only on profits and should therefore not be relevant for a typical purchaser SPE). In 2003, Germany enacted an exception from this add-back rule for purchasers that exclusively purchase loans or credit risks originated from banking activities, and finance such purchases through the issuance of debt titles (or through a loan extended by a separate vehicle that exclusively issues debt titles relating to such loans or credit risks and extends loans to such purchasers). This exception does not apply to the purchase of receivables from non-banks (*e.g.*, trade or lease receivables). On this basis, the coverage of trade tax risks by reserves has generally been a requirement for a rating of German securitisation transactions relating to non-bank assets. According to the envisaged German business tax reform 2008, however, the add-back rate for trade tax purposes may be changed from 50% of the interest expenses on long-term indebtedness to 25% on all interest expenses, no matter whether on long- or short-term indebtedness. This part of the reform is scheduled to become effective as of 1 January 2008.

Even where it can be established that a purchaser is effectively managed from outside of Germany, it may still have a taxable presence in Germany through the maintenance of a permanent establishment or a dependent agent in Germany.

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