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New Ruling on the Termination of a Letter of Comfort

The German Federal Court of Justice (*Bundesgerichtshof*) recently decided in a noteworthy ruling on the termination of a so-called letter of comfort (*Patronatserklärung*). A letter of comfort – also commonly referred to as a “letter of support” – is a promise by a parent company (patron) in relation to obligations that one of its subsidiaries has towards third parties, typically a commitment to provide sufficient funds to the subsidiary for it to be able to meet these obligations. Letters of comfort are often issued by a parent company to improve the creditworthiness of a subsidiary, thereby making it more attractive for third parties to enter into business relations with it. Since letters of comfort are neither regulated by German statutory law nor a frequent subject of court rulings, the mentioned “STAR 21” ruling dated 20 September 2010 (file number: II ZR 296/08) is significant for companies that make use of this form of collateral.

Letters of comfort are commonly distinguished by the legal obligation they impose on the patron: “Soft” letters of comfort are merely non-binding declarations of intent, whereas “hard” letters of comfort grant the beneficiary a direct legal claim. A letter of comfort can either be issued to the subsidiary itself (“internal” letter of comfort) or to its creditors (“external” letter of comfort). In case of an internal letter of comfort, it is the subsidiary who has a claim against the parent company, while an external letter of comfort leads to a direct claim of the creditor against the patron to provide the necessary funds to the subsidiary. In practice, “hard external” letters of comfort tend to be the rule. They allow the patron to independently decide on the measures it deems appropriate to strengthen the liquidity of the subsidiary, and at the same time adequately take into account the creditor’s interest by granting a direct claim against the patron.



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The termination of a letter of comfort often raises questions. The patron can of course explicitly set a fixed expiration date or a condition subsequent – which will automatically lead to the termination of the letter of comfort in case of a certain event – when issuing such a collateral. However, this may – in terms of commercial viability – not always be an option. The crucial question is therefore, under which circumstances the patron has the right to terminate a letter of comfort if it does not expire automatically after a certain period of time or in view of a specific event. In principle, the patron is entitled to terminate the letter of comfort after a certain waiting period and provided that sufficient notice period has been observed. In its “STAR 21” ruling, the German Federal Court of Justice further clarified the conditions under which a patron may be entitled to terminate a letter of comfort: In the case at hand, the subsidiary was in a financial crisis. The parent company therefore issued a letter of comfort to this subsidiary, in which it promised to settle all of the subsidiary’s debts in order to prevent it from becoming legally over-indebted and thus obliged to file for insolvency. Several months later, after having come to the conclusion that subsidiary’s crisis could not be overcome, the parent company terminated the letter of comfort. The subsidiary filed for insolvency immediately thereafter. The subsidiary, now represented by the insolvency administrator, subsequently sued the parent company for damages in the amount of the claims filed by third parties within the framework of the insolvency proceedings on the grounds that the parent company had illegally terminated the letter of comfort. However, as the parent company was able to prove in the proceedings, the parent company and the subsidiary had agreed when the letter of comfort was issued that it was not supposed to be valid for an indefinite period, but only for the time needed for the parent company to consider the commercial options for a recapitalization – potentially involving external investors – of the subsidiary. The court therefore held that the parties had implicitly agreed that the parent company had a right to terminate the letter of comfort once it had determined that it was not possible to reorganize the subsidiary’s finances.

It is important to note that the court decided the question whether the parties had agreed on the patron’s right to terminate the letter of comfort exclusively on the basis of its interpretation of the parties’ submissions, since the wording of the letter of comfort in and of itself was not sufficiently clear in this respect. Therefore, it is very advisable to explicitly state in the text of a letter of comfort the specific function the letter is supposed to serve according to the parties involved and to set forth the circumstances that entitle the patron

to terminate it. Where appropriate, setting a fixed expiration date or mentioning a specific event that will lead to an automatic termination of the letter of comfort may be alternative options to prevent a patron from being held liable under a letter of comfort beyond the parties’ commercial intentions.



**BY DR. REBEKKA HYE-KNUDSEN,
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Commercial Lease Agreements in Times of Crisis

In times of the global economic crisis, landlords face an increasing number of illiquid commercial tenants or even tenant insolvencies. What are the consequences for the lease relationship in such a case? How can the landlord reduce the risks of a total loss of rent?

In most cases, commercial lease agreements run for a fixed term (e.g. ten years) without any ordinary termination right for the landlord. One option to reduce the risk of loss of rent due to an illiquid tenant is to include an extraordinary termination right without notice in case of economic decline of the tenant in the lease agreement. However, even if the lease agreement does not include such an extraordinary termination right, the landlord is not unprotected, as he may be able to rely on statutory extraordinary termination rights. Sec. 543 Para. 2 No. 3 of the German Civil Code entitles the landlord to terminate the lease agreement without notice, if the tenant does not pay the rent either for a consecutive period of two months (No. 3 a) or in a total amount of at least two monthly rents (No. 3 b).

In case the tenant files for insolvency and the court decides to open preliminary insolvency proceedings (*vorläufiges Insolvenzverfahren*), the landlord is according to German insolvency law no longer allowed to terminate the lease agreement for the aforementioned reasons to the extent that they relate to the period before the opening of the preliminary insolvency proceedings. However, the landlord can terminate the lease agreement, if the rent – as set forth above – is (again) not paid after the preliminary insolvency proceedings have been opened.



While the aforementioned termination options enable the landlord to terminate a lease agreement before the end of the agreed term, they do not help to clear the leased premises for a potential new tenant. The vacation of the premises can only be accomplished by enforcement of an executory title for vacation of the premises (*Vollstreckung des Räumungstitels*). Such a title for vacation can be obtained by means of an according court decision. The landlord can on the basis of such a decision order a bailiff (*Gerichtsvollzieher*) to enforce the vacation. However, such court proceedings may go on for quite some time, and in this period no rent is generated for the premises. Therefore, an additional measure to reduce the risks of a loss of rent is a notarized declaration by the tenant with which it submits to immediate enforcement of a claim for vacation of the premises (*Unterwerfung unter die sofortige Zwangsvollstreckung des Räumungsanspruchs*). In this case, the landlord can after termination of the lease agreement order the bailiff to directly enforce the claim for vacation by delivery of the notarized submission to immediate enforcement, i.e. the landlord does not need to initiate court proceedings against the tenant.

However, even if the tenant has accepted a submission to immediate enforcement, the opening of preliminary insolvency proceedings will prevent the enforcement, if the court orders the preliminary cessation of any enforcement against the tenant's estate. In this case, the landlord must wait for the opening of the actual insolvency proceedings, which usually takes place within three months after the opening of the preliminary insolvency proceedings. After the opening of the actual insolvency proceedings, the landlord can still not enforce the executory title for vacation of the premises, but can at least claim "restitution of the premises" from the insolvency administrator (*Insolvenzverwalter*). This means that the insolvency administrator must only provide direct access to the property, but e.g. not remove installations made by the tenant or remedy defects.

To conclude, there are several options to reduce the risk of a landlord of a total loss of rent in fixed term contracts: a) insertion of an extraordinary termination right in case of economic decline of the tenant, b) termination of the lease agreement due to lack of rent payments for two months (in a row or in total), and c) a notarized declaration of a submission to immediate enforcement of the claim for vacation of the premises.

In all cases, the opening of preliminary insolvency proceedings may block the termination or the vacation of the premises for a certain period of time. Therefore, the landlord should react quickly when reasons for termination of the lease agreement are on hand. It is furthermore always advisable to check the financial situation



of the tenant very carefully before concluding a lease agreement and to request a deposit from the tenant.

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Lifespan Extension for Nuclear Power Plants in Germany

On 1 January 2011, the acts by the German Federal Parliament (*Bundestag*) concerning the lifespan extension for nuclear power plants entered into force. However, there are uncertainties about the legislative procedure that led to the passing of these acts, which might result in proceedings before the German Constitutional Court (*Bundesverfassungsgericht*) and the annulment of these acts.

Even before Germany's first nuclear power plant was commissioned in 1960, the question whether or not and especially how nuclear power should contribute to Germany's energy production was subject to controversial political debate. After 42 years of nuclear operated power plants, the Nuclear Exit Act (*Gesetz zur geordneten Beendigung der Kernenergienutzung zur gewerblichen Erzeugung von Elektrizität*) was enacted in 2002. It stipulated that by 2021 all nineteen active nuclear power plants had to be phased out. In order to achieve that objective, two nuclear power plants were shut down in 2003 and 2005. In October 2009, the then newly elected German government agreed in its coalition treaty that nuclear energy should serve as a bridging technology until renewable energies could substitute nuclear power. Since that objective could not be achieved by 2021, the German government and the nuclear power plant operators (E.ON, RWE, Vattenfall and EnBW) agreed on a license extension for the nuclear power plants (*Laufzeitverlängerung*). The acts on the license extensions (*Elfte und Zwölftes Gesetz zur Änderung des Atomgesetzes*), which were passed by the German Federal Parliament on 28 October 2010, amend the Atomic Energy Act (*Atomgesetz*) in order to extend the licenses of nuclear power plants depending on their age. The licenses of the seven nuclear power plants built up until 1980 are extended for another eight years, calculated from the time of the scheduled shutdown as of 2002. The licenses of the ten



nuclear power plants built after 1980 are extended for another fourteen years. However, the license extensions are not tied to the actual granted years, but to the energy volumes each power plant is allowed to produce during that time. Therefore, nuclear power plants might even continue to operate beyond the year 2036.

In return for the extended licenses, the nuclear power plant operators are obliged to pay a new Nuclear Fuel Elements Tax (*Brennelementesteuer*) to the German Federation (*Bund*). The tax will amount to approximately EUR 2.3 billion per year. In addition, the operators have to place a certain share of their revenues in an investment fund for renewable energies (*Energie- und Klimafonds*). The fund comprises EUR 300 million in 2011 and 2012 and EUR 200 million from 2013 to 2016. As of 2017, the amounts to be placed will depend inter alia on the development of the consumer price index and the electricity exchange prices.

Even though the German Federal Parliament passed the aforementioned legislative acts, the crucial question is whether or not the Federal Council of Germany (*Bundesrat*), where the Federal States (*Bundesländer*) are represented, would have had to participate in the legislative procedure by approving the acts. According to the German government, no approval by the Federal Council was required, as the new acts only extend the phase-out period under the existing Atomic Energy Act, but did not amend the Atomic Energy Act in a material way. The opposition dissents with that view and believes that the acts required the Federal Council's assent (*Zustimmungsgesetze*). When the acts were executed by the President of Germany on 8 December 2010, the opposition parties and nine of Germany's sixteen Federal States announced that they would challenge the way in which the acts were passed and bring an action before the German Constitutional Court. Thus, even though the acts entered into force on 1 January 2011, the German Constitutional Court is likely to have the final say in this matter.



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