

In Germany, commercial banks and other asset based financiers as lenders or sale and lease back counterparties often acquire title to or security interests over the borrower's movable assets, including fixed assets and inventory. However, in many cases, the value of such collateral is reduced due to priority rights of third parties, the most important being retention of title rights from suppliers and statutory liens of landlords. Regarding the latter, borrowers have in the past frequently been able to provide waivers issued by the landlord for the benefit of the lenders. Lenders, relying on such waivers, include the respective assets in their borrowing base calculation, resulting in increased finance volumes. A recently published decision of the BGH has shown that a landlord's waiver may not provide protection in case of a sale of the property by the landlord to a third party.

The Case

A borrower provided to its bank collateral by way of a security transfer of assets agreement in October 2006. The assets were located on premises which the borrower had leased in August 2006. The landlord provided a declaration to the bank in October 2006 waiving its statutory first ranking lien over the borrower's assets. In December 2006, the landlord sold the property to a third party. The new owner continued the tenancy agreement with the borrower. In 2008, the borrower became insolvent. Both the new landlord and the bank claimed preferred security rights over the borrower's assets on the leased premises. The new landlord claimed that its outstanding claims for rent were secured by the assets under the statutory landlord's lien, while the bank claimed the priority of the security transfer. The insolvency administrator rejected the priority right of the landlord and distributed the proceeds from the sale of these assets to the bank on a purported priority basis. The new landlord then sued the insolvency administrator for damages. Both the district court as well as the court of appeal dismissed the case, but the new landlord did not give up, and the BGH had to decide on this matter (Judgement of October 15, 2014, XII ZR 163/12).

The Decision

The relevant legal question which the BGH had to consider was how the legal framework of the statutory landlord lien works in the case of a property transfer.

Section 562 of the German Civil Code provides that a landlord has a statutory lien over the assets owned by the tenant which are located on the leased premises, which secures the landlord's payment claims under the tenancy agreement. The respective lien comes into existence at the time when the relevant assets are brought to the premises, and also covers all assets owned by the tenant which were already located at the premises at the beginning of the tenancy agreement.

Sections 578, 566 of the German Civil Code provide that in case of the transfer of a real estate property which is subject to a commercial tenancy agreement, the new owner of the property assumes the rights and obligations of the transferor. A new tenancy agreement comes into existence between the new owner of the property and the tenant with the same contents as the original tenancy agreement.

The court of first appeal had decided in respect of the new landlord's lien, that the relevant point in time to assess whether an asset is owned by the tenant and thus subject to the lien is the time of the transfer of the ownership in the property to the new landlord. In the case in question, because the borrower had transferred the ownership in the assets to the bank by way of the security transfer agreement before the property transfer, the borrower as tenant was not the owner of the assets at the time of the property transfer. Consequently, the court of first appeal decided that these assets were not subject to the new landlord's lien, and that the insolvency administrator had rightfully distributed the proceeds to the bank as secured creditor. The BGH reversed this decision and ruled that the relevant point in time to assess the coming into existence of the statutory landlord's lien of the new property owner is the time of the beginning of the original tenancy agreement which passes over to the new landlord. At that time (August 2006) the assets had not yet been transferred to the bank as security and were still owned by the borrower, so that the new landlord obtained a statutory landlord's lien in respect of these assets which was not subject to the subsequent waiver granted by the original landlord. This statutory lien of the new owner exists parallel and in the same rank as the respective lien of the original owner of the property. According to the BGH, the subsequent security transfer to the bank did not affect the lien of the new landlord, and the new landlord's lien had therefore priority over the security position of the bank.

Implications of the Decision

In its decision, the BGH focusses exclusively on the question of timing of coming into existence of the liens of the new property owner, and did not address the implications of the waiver declared to the bank by the previous owner. Without having explicitly stating this in the judgment, the BGH seems to have been of the opinion that the waiver declared by the landlord in October 2006 did not adversely affect the new landlord's lien. It is possible that the BGH would have viewed the situation differently in case that the waiver declaration of the original landlord was made by way of a formal amendment to the original tenancy agreement prior to the property transfer. In that case, it would have been possible to argue that because the new owner assumes rights and obligations under the existing tenancy agreement "as is", such waiver would have been binding on the new property owner as well. However, as the parties had not complied with the burdensome formal requirements of a formal amendment to the commercial tenancy agreement, but the bank had relied on a separate waiver declaration issued by the original landlord, the BGH did not need to address this point in its decision.

The decision of the BGH is unexpected and has already raised substantial objections from legal scholars in Germany. The critics point out that the decision allows landlords to retroactively reduce the value of security ownerships of financial creditors by transferring the property. Also, while the purpose of the relevant legal provisions is to protect the rights of a tenant against its landlord in case of a property transfer, it now serves as a protection of the new landlord to the detriment of the tenant (and the tenant's third party creditors).

The case decided on by the BGH related to a loan secured by a security transfer of title to the relevant assets situated in the leased premises. However, since the BGH decision is a dogmatic decision of principles it will also apply to sale and lease back transactions in relation to equipment originally owned by the tenant of a leased property.

Accordingly, all lenders as well as counterparties to sale and lease back transactions need to take into account this court decision in their future evaluations of landlords' declarations of waiver of statutory landlords' liens and the value of security assignments and other transfers of movable assets. It can be expected that the requirements for landlord waivers will change and become more cumbersome for the borrowers to obtain. Banks may consider requiring additional undertakings from the landlords, e.g. no sale of the property unless the acquirer has also declared a landlord waiver, additional reporting requirements of the borrower and/or the landlord in case of any (proposed) transfer of the property, etc. Absent such waivers, the borrowing base available for ABL facilities may also become reduced.

Not only financial creditors, but also insolvency administrators need to be aware of this new decision of the BGH. In case of a property transfer during the term of a commercial lease, conflicting security rights of landlords and creditors will become more difficult to sort out in many circumstances, resulting in increased liability risks for the insolvency practitioners.

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