

PRACTICAL INFORMATION

JULY 2017



HERMES COVER SPECIAL

Letter of undertaking – explanatory notes

EXPORT CREDIT GUARANTEES OF THE
FEDERAL REPUBLIC OF GERMANY

► **Hermes Cover**

► Letter of undertaking – explanatory notes

The exporter is required to sign a letter of undertaking in connection with each buyer credit guarantee. In certain cases, a subcontractor's letters of undertaking may also be necessary. Many questions arise with respect to the significance and specific content of these letters.

Part I of this brochure describes the purpose of the letter of undertaking and subcontractor's letter of undertaking. Part II contains answers to detailed questions which are frequently asked about the specific elements of these letters.

I. GENERAL INFORMATION

WHAT IS THE PURPOSE OF THE LETTER OF UNDERTAKING?

With every export transaction for which the Federal Government provides buyer credit cover, the letter of undertaking integrates the exporter in the contractual relationship between the bank and the Federal Government. It sets out the requirements which the exporter would also need to observe in the case of a supplier credit guarantee. This means that when an exporter utilises a buyer credit covered by a guarantee from the Federal Government to finance its business it is placed in the same position that it would also have if it granted its customers the credit terms itself and covered the transaction with a supplier credit guarantee granted by the Federal Government. As the exporter is included in this way, it is also possible for the Federal Government to assume abstract liability for indemnification, which in particular is independent of any disruptions or errors in the execution of the export transaction. The abstract nature of the buyer credit cover makes a crucial contribution to banks' willingness to provide finance.

WHAT ARE THE MAIN ELEMENTS OF THE LETTER OF UNDERTAKING?

The exporter undertakes to provide the Federal Government and the financing bank with certain information on the export transaction of relevance for the buyer credit guarantee. At the same time, the exporter declares its willingness to assume liability towards the Federal Government if, in the event of a claim, the Federal Government is required to indemnify the bank in cases in which the exporter itself would not be entitled to an indemnification due to a breach of duty under a supplier credit guarantee.

This is the case, for example, if the export transaction has arisen as a result of bribery, the exporter has misrepresented the origin of the goods included in the delivery to be financed or the foreign buyer fails to repay the loan on the grounds of defective or incomplete performance of the delivery or service contract, meaning that warranty claims arise under the export contract.

WHAT PARTICULAR FACTORS MUST BE OBSERVED IN CONNECTION WITH THE SUBCONTRACTOR'S LETTER OF UNDERTAKING?

The subcontractor's letter of undertaking has been created for the purpose of extending the right of recovery to include the main exporter's subcontractor(s) if its creditworthiness is not considered sufficient to cover any right of recovery accruing to the Federal Government. For this reason, a letter of undertaking by the main subcontractors is obligatory in trading transactions.

The wording of the subcontractor's letter of undertaking reflects the fact that there is no direct contractual relationship between the subcontractor and the foreign buyer. For this reason, the subcontractor's reporting duties and co-liability are a priori confined to its share in the delivery transaction in contrast to standard letters of undertaking. In view of these restrictions to the word-

ing, the subcontractor's letter of undertaking is also used in cases in which the German exporter is the subcontractor of a non-domestic main exporter.

WHAT RISKS DOES THE LETTER OF UNDERTAKING INVOLVE?

The letter of undertaking does not entail any additional requirements over and above those applicable to supplier credit cover. Accordingly, the exporter does not expose itself to any additional risks by signing the letter of undertaking if it executes the export transaction with all due care and in accordance with the terms of the contract.

WHEN DOES LIABILITY UNDER THE (SUBCONTRACTOR'S) LETTERS OF UNDERTAKING EXPIRE?

Liability under the (subcontractor's) letters of undertaking expires upon the discharge of the buyer credit cover, i.e. normally upon full repayment of the guaranteed loan receivable. It is not possible for the duration of the (subcontractor's) letters of undertaking to be shortened in individual cases. However, it should be noted that in accordance with the individual clauses the liability of the exporter/subcontractor may expire at a substantially earlier stage. Thus, liability arises on account of defective performance of the delivery/service contract in accordance with Number 5 of the letter of undertaking or the subcontractor's letter of undertaking only in cases in which the foreign debtor actually holds warranty claims against the vendor. Upon the expiry of the contractual or statutory warranty period, the Federal Government no longer has any right of recovery under Number 5 of the letter of undertaking. The duty to disclose any circumstances constituting an increase of risk in accordance with Number 1.b) applies only until full disbursement of the loan, meaning that the exporter itself is not required to monitor the financing transaction once the export transaction has been executed and the final loan instalment paid.

IN WHAT CASES IS A LETTER OF UNDERTAKING REQUIRED?

The Federal Government is only willing to provide an export credit guarantee for loans if it is in the interests of the German exporter for the transaction to be financed. This is expressly stated in the letter of undertaking. For this reason, the German exporter must submit a letter of undertaking for every transaction subject to buyer credit cover regardless of whether it has applied for export credit cover from the Federal Government or not.

CAN THE WORDING OF THE LETTER OF UNDERTAKING BE MODIFIED IN INDIVIDUAL CASES?

The wording of the letter of undertaking is generally applicable and binding. It is not possible to delete or modify individual parts of the wording.

WHAT IS MEANT BY "OBLIGATION TO INDEMNIFY ON FIRST WRITTEN DEMAND"?

If any of the requirements provided for in the letter of undertaking are breached, the exporter is required to indemnify the Federal Government in accordance with its duty of compensation under the buyer credit cover "on first written demand". This means that in the event of a claim the exporter and not the Federal Government must pay the compensation to the bank.

Despite the inclusion of the words "on first written demand", a (possible) payment obligation on the part of the exporter cannot ultimately be likened to a guarantee in the customary sense. This is already reflected in the wording of the letter of undertaking or subcontractor's letter of undertaking, which provides for various restrictions. In any case, the Federal Government assumes that the facts of the matter would be clarified before any claims were asserted against the exporter.

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Thus, for example, if the borrower refused to repay the loan due to alleged defects in the performance of the delivery/service contract (Number 5 of the letter of undertaking and subcontractor's letter of undertaking), the Federal Government would never rely solely on the buyer's arguments without first ascertaining their justification but would initially determine whether the exporter/subcontractor was liable under the terms of the warranty. Only if there were substantiated evidence pointing to the existence of such liability would the Federal Government consider whether it held any recovery claims against the exporter, in which case it would also take due account of any arguments submitted by the exporter. Thus, in the case of any doubt, the bank would initially receive indemnification under the buyer credit guarantee. Only then would the Federal Government assert possible recovery claims against the exporter after clarifying the legal and factual situation to a sufficient degree.

To date, Number 5 (letter of undertaking and subcontractor's letter of undertaking) has not had any practical relevance. As loan contracts are typically abstract in nature, no claims based on the export transaction can be legally raised against the repayment obligation.

WHAT FACTORS MUST BE OBSERVED IF A GERMAN EXPORTER SUPPLIES THE ULTIMATE FOREIGN BUYER VIA A FURTHER NON-DOMESTIC COMPANY?

In this case, a (subcontractor's) letter of undertaking is required from the German exporter and, in principle, also a letter of undertaking from the non-domestic company. If the non-domestic company is associated with the exporter in economic terms (e.g. it is a subsidiary), the German exporter can assume liability by completing a special form.

No separate letter of undertaking is required from an intermediate company operating on behalf of the buyer (e.g. an EPC contractor). In this case, the German exporter must submit a subcontractor's letter of undertaking.

II. SPECIAL QUESTIONS AND ANSWERS

LU = Letter of undertaking

SLU = Subcontractor's letter of undertaking

WHY DOES THE FEDERAL GOVERNMENT REQUIRE INFORMATION FROM THE EXPORTER (OR, WHERE APPLICABLE, THE SUBCONTRACTOR) ON THE EXPORT TRANSACTION, ITS PROGRESS AND ANY AGGRAVATION OF RISK? (NUMBER 1 LU AND SLU)

Naturally enough, the exporter is the party most familiar with the export transaction and is therefore the main source of information not only for the bank but also for the Federal Government on the transaction for which the Federal Government has been asked to provide an export credit guarantee. All the information furnished – particularly also in connection with the submission of the documents on which payment depends – must be free of any errors or omissions.

Prompt notification of any risk-aggravating factors during the loan disbursement period allows the Federal Government to intervene and limit the scope of cover under the buyer credit guarantee among other things, by excluding from the cover those loan amounts which have not yet been paid out provided that the corresponding deliveries have not yet been executed. In this way, the Federal Government is able to cap its risk under the buyer credit guarantee.

WHAT NOTIFICATION DUTIES MUST BE OBSERVED UNDER THE (SUBCONTRACTOR'S) LETTERS OF UNDERTAKING?

(NUMBER 1 LU AND SLU)

A distinction must be drawn between the obligation to completely and correctly describe the export transaction (Number 1.a.), to report any risk-aggravating factors to the Federal Government (Number 1.b) and to inform the Federal Government of the current progress of the export transaction and other factors which may be of relevance for the buyer credit guarantee.

The duty towards the vendor and the financing bank to completely and correctly describe the export transaction (Number 1.a) applies only in the period during which an application for buyer credit cover is made and processed. The duty to report any risk-aggravating factors (Number 1.b) expires upon full disbursement of the loan. On the other hand, the reporting duty towards the Federal Government (Number 1.c) applies throughout the entire term of the loan but arises only when a corresponding inquiry is received from the Federal Government.

WHAT LIMITS ARE THERE ON THE DUTY TO COMPLETELY AND CORRECTLY DESCRIBE THE EXPORT TRANSACTION IF THE NOTIFYING COMPANY ITSELF HAS NOT APPLIED FOR ANY COVER FROM THE FEDERAL GOVERNMENT?

(NUMBER 1.A LU AND SLU)

In this case, the Federal Government expects the exporter to answer any questions asked by the bank submitting the application free of any errors or omissions and to revise the answers submitted to the bank in the event of any subsequent changes. However, it is not necessary for the exporter to proffer this information unless it receives a corresponding inquiry from the financing bank. The same thing applies to subcontractors with respect to the subcontractor's letter of undertaking.

UNDER WHAT CONDITIONS IS THE FEDERAL GOVERNMENT ABLE TO CLAIM INDEMNIFICATION IN CASES IN WHICH THE EXPORTER (OR THE SUBCONTRACTOR) FAILS TO COMPLY WITH ITS DUTY TO PROVIDE INFORMATION AND TO CORRECT ANY INFORMATION ALREADY SUBMITTED DURING THE APPLICATION PROCEDURE?

(NUMBERS 1 AND 2.A. LU AND SLU)

Liability on the part of the exporter (or subcontractor) arises only if the buyer credit guarantee is granted on the strength of incorrect or incomplete information such that, had the Federal Government been aware of the actual and full facts of the matter, it would not have granted any cover.

In addition, the exporter/subcontractor must be in breach of a duty of care ("aware or reasonably expected to be aware"): What is decisive in this case is that the employees of the exporter (or subcontractor) responsible for the export transaction in question were aware or, on the assumption that the business structure are properly organised, could be reasonably expected to have been aware of the error or omission in the information.

As a fundamental principle, each party submitting information is liable only for any breach of duty of its own employees.

MAY THE FEDERAL GOVERNMENT ASSERT CLAIMS AGAINST THE EXPORTER (OR THE SUBCONTRACTOR) IN ALL CASES IN WHICH THE LATTER FAILS TO OBSERVE ITS DUTY TO NOTIFY THE FEDERAL GOVERNMENT OF ANY AGGRAVATION OF RISK OR OTHERWISE FAILS TO SUBMIT INFORMATION?

(NUMBERS 1.B AND 1.C LU, NUMBER 2.B LU AND SLU)

No. Claims for indemnification can only be submitted if there is a causal link. In other words, the breach of duty on the part of the exporter must have caused the claim

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or must be expected to cause it. In the absence of any causal link between the breach of duty by the exporter and the claim under the buyer credit guarantee, the Federal Government cannot assert any claims against the exporter (or the subcontractor).

CAN THE FEDERAL GOVERNMENT LIMIT ITS CLAIM FOR INDEMNIFICATION IN FAVOUR OF THE EXPORTER? (NUMBER 3 LU AND SLU)

Yes. Number 3 reflects the principle of reasonableness. This means that the Federal Government may only assert claims under the letter of undertaking which are reasonable in the light of the exporter's breach of duty. The Federal Government is free to decide at its own discretion whether to assert any claims against the exporter under the letter of undertaking. A comparable provision also applies to supplier credit cover (Art. 16 (4) GC (G)).

WHAT HAPPENS IF AN EXPORT TRANSACTION HAS ARISEN ON ACCOUNT OF BRIBERY? (NUMBER 4 LU AND SLU)

The Federal Government is not permitted to provide any cover for export transactions arising as a result of bribery. During the application procedure for supplier credit cover the exporter must also declare that the transaction has arisen or will arise without any bribery. If this declaration subsequently proves to be untrue, the Federal Government will be relieved of any liability in the event of a claim and the premium paid will be forfeit.

For this reason, the letter of undertaking (and the subcontractor's letter of undertaking) includes a corresponding provision as the Federal Government is obviously not willing to support any finance for an export transaction which has arisen as a result of bribery.

WHAT IS THE SITUATION IF THE DEBTOR REFUSES TO REPAY THE LOAN ON THE GROUNDS OF DEFECTIVE OR INCOMPLETE PERFORMANCE OF THE DELIVERY OR SERVICE CONTRACT? (NUMBER 5 LU AND SLU)

Under supplier credit cover, the exporter does not receive any indemnification if the foreign buyer's complaints are justified (Art. 5 Paragraph 2, Sentence 2 GC (G)). Rather, the onus is on the exporter to prove that it is actually entitled to claim payment. For this reason, the Federal Government has a right of indemnification against the exporter under the letter of undertaking (and the subcontractor's letter of undertaking) if the foreign buyer refuses to repay the loan on the grounds of defective or incomplete performance of the delivery or service contract.

However, this occurs only rarely in practice as the debtor generally accepts the abstract nature of the loan, meaning that the claims held by the bank are honoured notwithstanding the defective or incomplete performance of the delivery or service contract.

In any case, the Federal Government will generally compensate the bank and only then assert recovery claims against the exporter. In this case, it would also take account of any counterarguments on the part of the exporter.

WHAT MUST BE OBSERVED IF THE LOAN IS DISBURSED IN THE FORM OF PROGRESS PAYMENTS? (NUMBER 6 LU AND SLU)

In the case of delivery contracts for which progress payments are stipulated, there is a heightened risk of disruptions in the delivery affecting the repayment of the loan. This risk would be borne by the Federal Govern-

ment as the provider of cover for the loan. Accordingly, the exporter is also liable in cases in which it would not receive any indemnification itself under export credit cover (manufacturing risk cover in this case).

Even under manufacturing risk cover, indemnification claims would only arise provided that certain conditions specified in greater detail in the General Terms and Conditions were satisfied. Whether the exporter has actually taken out manufacturing risk cover from the Federal Government in this specific case is irrelevant.

Number 6 applies only if the “progress payments” option is actually selected in the loan agreement and documented in the buyer credit guarantee (as a special condition).

WHAT PARTICULAR FACTORS MUST BE OBSERVED IN CONNECTION WITH CONSORTIA AND JOINT VENTURES? (NUMBER 7 LU)

If the contractual partner of the foreign buyer is a consortium or joint venture, the lead manager of the consortium (or a representative of the members of the joint venture) must submit the letter of undertaking on behalf of the other consortium members.

Although all parties are jointly liable towards their buyer under the terms of the applicable contract, their liability towards the Federal Government under the letter of undertaking is limited to the absolute amount of their quota share in the transaction.

This provision also clarifies that the companies that are members of a consortium or joint venture are not held liable for the breach of duty of other members. If several participants are in breach of duty, each company is liable only for its own breach (and only up the amount of its share quota). If only a single participant has breached a duty, it is solely liable, in which case its liability is also limited to its own share quota.

WHAT IS MEANT BY “JOINT AND SEVERAL LIABILITY”? (NUMBER 9 SLU)

This refers to the fact that the Federal Government may at its discretion recover the amount owing either from the main exporter (“vendor”) or the subcontractor in cases in which both parties are required to indemnify it for the same amount. Obviously, the Federal Government can only recover this amount once.

Export Credit Guarantees and Untied Loan Guarantees: instruments to promote foreign trade and investment provided by the



Federal Ministry
for Economic Affairs
and Climate Action

Commissioned to implement the federal funding instruments Export Credit Guarantees and Untied Loan Guarantees:



EULER HERMES

Cover from the Federal Republic of Germany for foreign business

Export Credit Guarantees and Untied Loan Guarantees have been established and effective foreign trade promotion instruments of the Federal Government for decades. Export Credit Guarantees (so-called Hermes Cover) protect German exporters and banks financing exports against political and commercial risks. Untied Loan Guarantees are to support raw material projects abroad regarded as eligible for promotion by the Federal Government. Both promotion instruments play an important role in fostering economic growth as well as in protecting and creating jobs. Federal Government commissioned Euler Hermes Aktiengesellschaft to manage the federal funding instruments Export Credit Guarantees and Untied Loan Guarantees.

Information on other foreign trade promotion instruments of the Federal Government can be found at www.bmwk.de/en under the heading Promotion of Foreign Trade and Investment.

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