10 Generic Forms of Payment Obligations

10.1 Introduction

Traditional legal rules governing payment obligations have been designed for the most basic form of payment obligations: the obligation to pay a fixed sum of money.

In addition, it is normal to distinguish between different forms of claims according to their transferability and the enforceability of transfer. For example, under English law, “receivables” are “assigned”, but “negotiable instruments”, rights, and obligations are “transferred”. In German law, the transfer (“assignment”) of receivables is called “Abtretung” (Abtretung von Forderungen).\(^1\) The transfer of ownership is called “Übertragung” (Übertragung des Eigentums).\(^2\) Transferability and enforceability of the transfer will be discussed in sections 11.4 and 11.5 in more detail.

There are even other ways to distinguish between different forms of payment obligations. Payment obligations can be divided into six basic categories. A payment obligation can belong to one category or consist of a combination of obligations that belong to two or more categories. As will be explained below, the categories are: (1) legally unenforceable cash flows; (2) payments known in advance; (3) variable payment obligations; (4) payments whose amount depends on the value of an asset; (5) payments that depend on the occurrence of an event; and (6) options. Finally, there is a category that consist of (7) a combination of payment obligations that belong to two or more categories.

The legal aspects of payment obligations and the management of counterparty risk depend on the form of the obligation in question.

10.2 Legally Not Enforceable Cash Flows

Some possible cash flows are not legally enforceable. (a) For example, a minor shareholder may not be able to force the company to pay dividends. The people who control the company tend to have plenty of discretion in this respect. Ultimately profits will be paid out to shareholders, but a shareholder does not know

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\(^1\) See § 398(1) BGB: “Eine Forderung kann von dem Gläubiger durch Vertrag mit einem anderen auf diesen übertragen werden (Abtretung).”

\(^2\) For example, § 929 BGB.

when this will happen and how much will be paid out (Volume III). (b) Payment obligations under comfort letters provide another typical example of legally not enforceable cash flows. Many comfort letters are designed to create moral obligations (section 5.6.2) rather than payment obligations enforceable by the court. (c) Furthermore, many non-binding contracts can, in practice, influence the behaviour of the parties. This is often the case where failure to perform under a non-binding contract would have adverse consequences (for sanctions, see section 6.3.3).

10.3 Legally Enforceable Payment Obligations

The other categories of payment obligations contain legally enforceable obligations. The recognition and enforceability of payment obligations is important to contract parties, because it reduces risk and enables parties to contract on value transfer, future chance outcomes, and the transfer of financial claims.

Payments known in advance. The legal framework may lay down the sums to be paid and when the payments are due. This is the most basic case of legally enforceable payment obligations. For example, these payment obligations can be found in traditional customer credits, term loans, revolving facilities, and overdrafts.

Variable payment obligations. The legal framework may lay down when payments are due but leave the size of those payments dependent on future events. The firm may agree to use variable payments for many reasons. For example, it may be a way to increase the flexibility of a long-term contract (section 5.5.4).

Another example can be found in business acquisition contracts. Parties to a business acquisition contract may agree on an earn-out clause according to which part of the purchase price will depend on the target’s performance and future earnings (Volume III).³


In mezzanine finance, an equity investor may sometimes prefer to use a back-ended fee instead of an equity kicker (Volume III).⁴

⁴ See, for example, Barthold BM, Mezzanine-Finanzierung von Unternehmensübernahmen, SZW/RSDA 5/2000 pp 226–227: “In Deutschland ist zudem die ‘back-ended fee’ gebräuchlich. Dabei handelt es sich um eine Einmalzahlung zum Ende der Laufzeit des Mezzanine-Darlehens, die als ein Prozentsatz an der Wertsteigerung des finanzierten Unternehmens vereinbart wird und in Geld erfolgt. Der equity kicker wird in dieser Form ausgestaltet, um eine Verwässerung der Rechte der Aktionäre im Einzelfall zu vermeiden, die sonst infolge der Ausübung des Options- oder Wandelrechts durch den Investor eintreten würde.”