

## Commercial Property - Germany

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### Changing the Basis of Price Indices

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#### Introduction Case

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The property industry regularly faces the question of how rent increases which are based on price index clauses should be calculated, when there has been a change in the basis of the index since the last rent increase or such a change has been published.

Every five years, the standard indices are recalculated by the German Office of Statistics based on a new "shopping basket of goods" to take into account changes in consumer behaviour.<sup>(1)</sup> This means that each new index is based on a new reference year and, as such, is composed differently. Thus, comparing indices based on different reference years is problematic.

In addition, series of indices are not published until approximately two years after the reference year upon which they are based. For example, the consumer price index for reference year 2000=100 was not published until February 2003, and the consumer price index (basis 2005=100) which is in use at present was not published until January 2008.

Until February 2003 (when it published the consumer price index basis 2000=100), in order to ease the problems relating to the changing basis of the index, the Office of Statistics used to provide conversion factors to enable previously published series of indices (eg, the cost of living index for a four-person working-class household) to be adapted to new basis years. However, because the office has maintained the consumer price index only since the change to the reference year 2000=100, and because the conversion factors inevitably involve inaccuracies, it no longer publishes these factors. Since then, the calculation of rent payments on the basis of index clauses has posed the question of how to proceed if the basis of the index has changed between two rent increases or if a new series of indices has been published during that period.

In its ruling of March 4 2009 (XII ZR 141/07) the Federal Court of Justice clarified how the transition between different indices can be dealt with if there are no applicable provisions in the relevant rental contract. Any specific agreements between the parties on the succession of indices take priority over the supplementary contract interpretation given by the court in its ruling.

#### Case

##### *Points clause*

The court had to decide on a 'points clause' which made a rent increase dependent on whether the outdated index for the cost of living of a four-person, working-class household (basis 1980=100) had increased or decreased by 10 points or more compared with the index for a certain month. This index had not been updated since the conversion to the reference year 2000=100. First, the court ruled in a supplementary interpretation of the contract that the parties would have based their index clause on the consumer price index that is now published if they had considered the possibility that their chosen cost of living index might be discontinued. The court justified this view by stating that the consumer price index which is in use at present gives the best reflection of the price development which was observed by the former cost of living index, and therefore "for want of suitable alternatives", the parties would have had to base their index clause on this index. This line of argument can be generalized and applied to all other price index clauses.

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### **Index increase**

Second, the court had to decide how the index increase could be calculated following the selection of a points clause. This was necessary because the statistical calculations underlying the index mean that an index with an earlier reference year will increase more quickly than an index with a more recent reference year. Therefore, the same points difference within a series of indices reflects different inflation rates. For example, an increase by five points from 100 index points to 105 index points represents a higher inflation rate than an increase of the same index series from 120 to 125 points. In view of these mathematical and statistical considerations, the index series for a points clause cannot be simply connected in a linear manner so that, for example, the last seven points from the index (reference year 2000=100) are simply added to the first three points from the index (reference year 2005=100) to reach the index threshold of 10 points, as is stipulated in the price index clause. According to the court, the only way to solve this problem is through the use of a transition calculation method combining the calculations for the old and new index series. The court suggested two different calculation methods which could achieve this. One of the two methods is based on the calculation programme provided by the Office of Statistics.

### **Transition**

Third, the court had to decide at what point in time this transition between the two index series should take place. A transition would be possible upon the first publication of the new index (ie, retrospectively, as from the beginning of the new reference year). However, a transition would also be plausible at the latest possible time (ie, the time of the last publication of the old index). This can be illustrated by considering the present index (reference year 2005=100) which was published in January 2008 to take effect retrospectively as from January 2005. Here, a transition would be possible either as from January 2005 or as from January 2008. The literature to date has recommended that the transition take place at the latest time possible – January 2008 in this example – because the parties selected the original index and thus it is their interests to use that index for as long as possible.

On the other hand, the Office of Statistics recommends that the transition take place at the earliest possible moment. This position is based on the mathematical and statistical argument that, upon publication of a new reference year, it is not valid to update the previous index. The calculation programme provided by the Office of Statistics is based on this recommendation.

The court gave its blessing to the Office of Statistics's calculation programme and associated interpretation of the will of the parties on the basis that it was the most practical approach to this problem. The court also pointed out that parties must expect the reference year to change at intervals of five years and, therefore, cannot base agreements on a more long-term calculation of the index (although parties are naturally entitled to agree on different provisions). The court also pointed out that the calculation results based on the first possible transition time and the last possible transition time are likely to differ only to a very small extent and as such rarely have a significant impact on the rent.

However, the court explicitly left the question unanswered of whether a transition at the earliest possible time must then be selected in the process of interpreting the contract if a percentage clause is agreed. It pointed out that its ruling was not comparable with a case of October 31 2008, in which the decision was related to a percentage clause. In the earlier ruling, the court selected the latest possible transition time for a percentage clause. However, the question before the court in this case involved a non-recurring adjustment of a purchase price. Since a calculation based on two different series of indices is easier with a percentage clause than it is with a points clause, such a calculation is not dependent on the calculation programme provided by the Office of Statistics. Thus, the practicality argument which the court used to justify its ruling is unlikely to play a role in future rulings which involve percentage clauses.

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### **Endnotes**

(1) The German Office of Statistics calculation programme can be accessed at [www.destatis.de](http://www.destatis.de).

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