PROPERTY RIGHTS IN EASTERN GERMANY: AN OVERVIEW OF THE AMENDED PROPERTY LAW

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I. INTRODUCTION

One of the greatest legal challenges in the unification of Germany is the restitution of, or payment of compensation for, property in eastern Germany expropriated by the former East German regime, and before it, by the Nazi dictatorship. In order to achieve this end, the Unification Treaty of August 31, 1990,1 and a number of statutes incorporated in it, such as the Law Regulating Open Property Questions2 (the "Property Law") and the Law on Special Investment in the German Democratic Republic3 (the "Investment Law") established a basic right of restitution for expropriated property. Since unification, however, the economic disintegration of eastern Germany has forced the German government to intensify its efforts to promote investment in eastern Germany. Many investors, however, have remained wary of acquiring property subject to restitution claims. The legal goal of restoring property rights and the economic goal of promoting investment quickly came into conflict with each other.

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The prospect of restitution of expropriated property resulted in the filing of between one and one-half to two million restitution claims, overwhelming the authorities and courts responsible for processing claims. At the same time, the massive number of such claims discouraged investors from acquiring enterprises and property since the mere existence of the claims tended to render property titles insecure.

To remedy this situation, the German Parliament enacted an important law on March 22, 1991 affecting property rights in eastern Germany: the Law on the Removal of Obstacles for the Privatization of Businesses and for the Promotion of Investment (the "Law"). The new Law amends a number of existing statues, including the Property Law. Generally, the Property Law provided for the restitution of property expropriated by the government of the German Democratic Republic, subject, however, to certain exceptions that sought to protect acquisitions of property by investors. However, it still did not appear to many investors to provide an adequate degree of security, nor did it dispense with some of the burdensome procedural requirements for the acquisition of property for investment purposes. To address these problems, the German government proposed the Law, with the goal of providing greater protection to investors and granting more flexibility to the authorities charged with privatizing former state-owned enterprises.

The legislation was the subject of vigorous debate in the German Cabinet and in the Parliament, largely centering on the issue whether restitution or compensation should be the basic means of redress for expropriation of property. When the Law was finally enacted by the Parliament, the portions of the Law amending the Property Law preserved the basic priority of restitution of expropriated property over compensation, while at the same time expanding the investment-oriented exceptions to restitution.

This article will provide an overview of the Law as it affects property rights. Although the Law amends a number of other important statutes, its amendment of the Property Law is perhaps of greatest interest to foreign investors.

II. Scope and Definitions

The Law applies, as noted above, to expropriations conducted by the National Socialist régime between 1933 and 1945, and by the

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East German Government between 1949 and 1990. It specifically provides that it does not apply to expropriations that occurred during the period of Soviet occupation from 1945 to 1949, an exception that was upheld against constitutional attack by the Federal Constitutional Court in a decision of April 23, 1991.\(^5\) The Law also excludes from its scope legal claims that have been the subject of international treaties entered into by the German Democratic Republic, as well as to municipal property as defined by Section 21 of the Municipal Property Law of July 6, 1990.\(^6\) No right to either restitution or compensation exists with respect to any property excluded from the scope of the Law.

The Law generally provides for restitution of all expropriated property within its scope, unless otherwise specified. For purposes of the Law, "property" includes: improved and unimproved real property and building, rights of use (Nutzungsrechte)\(^7\) and other intangible rights (dingliche Rechte),\(^8\) bank accounts and other monetary claims, and property rights in business enterprises with a principal place of business or a subsidiary in eastern Germany.

The Law differentiates between the former owner of the property in question (claimant)\(^9\) and the entity with the power to dispose of the property (disposing party).\(^10\) The disposing party in most cases,

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\(^5\) Judgment of Apr. 23, 1991, Bundesverfassungsgericht, (BVerfGE), 1. Senate, - 1 BvR 1170/90 -, - 1 BvR 1174/90 -, - 1 BvR 1175/90 -.


\(^7\) "Nutzungsrechte" as used in the Law includes all usufructs of immovable property, such as easements in gross, or affirmative easements.

\(^8\) "Dingliche Rechte" as stated in the Property Law are absolute immaterial property rights with regard to real estate and buildings. Under German civil law, these include personal property, possession of property, usufructuary rights, and exploitation rights.

\(^9\) The Property Law uses the term "Berechtigter", which can be translated as "entitled party", and defines it as being all natural or juridical persons, all partners, as well as the legal successors of these entities that have been affected by measures of expropriation described in § 1 of the Law. Pursuant to the amended Property Law, the entitlement has to be claimed and sufficiently substantiated in order to accomplish restitution of property. Since the Law establishes the procedural and substantive rules and conditions necessary to establish an entitlement, and since these must be satisfied before a claim ripens into a right, the authors have chosen the term "claimant" for the sake of clarity.

\(^10\) Pursuant to § 2 (3) of the amended Property Law, the disposing party, for the purposes of restitution of enterprises, is the entity with partial or full possession or control of the property, or in case of corporations, the entity with direct or indirect equity interest in the corporation. With respect to other property, the sole proprietor, or possessor of the power of disposal is the disposing party.
is the Treuhand or the local government, but it may also be the state administrator (staatlicher Verwalter). Furthermore, property may be partially or fully controlled by a subsidiary of the Trust Agency (Treuhandanstalt), in which case the Treuhandanstalt acts as the sole lawful representative.

Under the Property Law, a restitution claim may be transferred or pledged. In the event there are several claimants to the same property, the party whose claim is based on the earliest expropriation has priority.

III. PROPERTY EXCLUDED FROM RESTITUTION CLAIMS

The Law exempts certain property from restitution claims. Specifically, the following categories of property are protected:

(i) All property, or all rights therein, for which reconveyance is not feasible given the present status of the property.

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11 Property Law, supra note 2, § 1 (4), §§ 11-15. State administration (staatliche Verwaltung) was a method by which the government of the former GDR deprived the owner of his property rights without formal expropriation. The amended Property Law provides for the termination of state administration over property of refugees from the former GDR, of citizens of the Federal Republic, of companies domiciled in the Federal Republic, and of foreign owners. It also governs claims against the government arising from such administration. State administration must be removed upon application by the former owner under the conditions specified in §§ 11 - 15 of the amended Property Law, which in turn generally apply the same requirements as discussed herein.

12 The Treuhandanstalt was created by the Law on Privatization and Reorganization of State-Owned Property - Treuhand Law - of June 17, 1990 (Gesetz zur Privatisierung und Reorganisierung des volkseigenen Vermögens - Treuhandgesetz vom 17. Juni 1990), 1990 GBl. I, No. 33. at 300, as amended by Article 9 of the Law on the Removal of Obstacles for the Privatization of Businesses and for the Promotion of Investments, supra note 4, with the objective of selling, restructuring, or liquidating the former state-owned companies. The Treuhandanstalt is the sole proprietor of most of the companies under its responsibility, making it the world's largest holding corporation. Although an entity with public law status, the Treuhandanstalt functions in a civil law capacity when transferring property to a purchaser. However, its deliberative procedures regarding whether and who may acquire shares in a specific company are governed by German public law. In order to decentralize and thereby speed up privatization, the Treuhandanstalt has been reorganized since its inception. Fifteen regional offices have been created and given the responsibility for 250-300 smaller enterprises to be sold within their geographical jurisdiction. The concept can be compared with the branch system of banking law. See generally Weimar, Treuhandanstalt und Treuhandgesetz, 35/36 Betriebs-Berater, Supplement 40, Deutsche Einigung - Rechtsentwicklungen, No. 17, at 10 (1990).

13 Property Law, supra note 2, § 3 (1) (second sentence).

14 Id. § 3 (2).
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(ii) Property that has been acquired in good faith and in reliance upon the then existing legal order by natural persons, non-profit foundations and religious associations. This exemption does not apply to real estate and buildings if the acquisition occurred after October 18, 1989 and which was not authorized pursuant to section 6, Subsections 1 and 2 of the Decree Concerning the Filing of Property Claims, of August 21, 1990 (the "Filing Decree").

Restitution of real property and buildings is excluded if:

(i) the use or dedication of the premises has been materially altered at considerable expense and the use is in the public interest;
(ii) the premises are dedicated to common use;
(iii) the premises are used for substantial housing purposes;
(iv) the premises are presently being used for industrial purposes or is part in a business entity and restitution would be impossible without severe impairment in the value of the entity.

Restitution is only excluded under (i) and (iii) if such circumstances were present on September 29, 1990.

Restitution of business enterprises is excluded if business operations have ceased and no commercially reasonable basis exists for resumption of operations, or if the business was sold based upon the provisions specified in section 4 of the Property Law. In addition, restitution is unavailable if an enterprise is not presently comparable to the business at the time of expropriation. Comparability is based

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15 Verordnung über die Anmeldung vermögensrechtlicher Ansprüche -Anmeldeverordnung - vom 21. August 1990, 1990 GBl. I, No., 56 at 1260, as last amended by the Third Decree Concerning the Filing of Property Claims of October 5, 1990, 1990 BGBl. I 2150. Section 6 of the Filing Decree provides that governmental approval for a sale of real estate may not be granted unless the former owner has consented, and such governmental approval may not be granted if an ownership claim by a former owner has not been decided. For an analysis of the procedure for filing claims, see generally Wilburn, Filing of U.S. Property Claims in Eastern Germany, 25 INT'L LAW 649 (1991).

16 Property Law, supra note 2, § 5 (2).

upon the similarity of products and services. If these remained largely unchanged except for normal technical developments, the business is subject to restitution.\textsuperscript{18} The present enterprise is also deemed comparable to the one at the time of expropriation if the previous products or services have been exchanged for other products and services that result in a substantial change in the entity that would require a significant increase in capital.\textsuperscript{19} Finally, according to section 6 (1a) of the amended Property Law, no right of restitution of an enterprise exists unless it, or one of its shareholders, or its members or legal successors of such persons constituting more than fifty percent of the shares or membership rights, file a claim for restitution of the business or shares or membership rights of such person(s) (Rückgabeberechtigter).\textsuperscript{20} If the necessary quorum cannot be assembled, a restitution claim may not be filed with respect to that entity.

\textbf{IV. BASIC PRINCIPLE OF RESTITUTION}

The basic principle of restitution is set forth in Section 3 of the amended Property Law. It provides that property that was expropriated and subsequently converted into peoples’ property (Volkseigentum), or transferred to a third party, is to be returned to the claimant upon application filed with the competent authority.\textsuperscript{21} With respect to enterprises, the restitution application may not be limited to certain parts of the enterprise, but must apply to the entire enterprise.\textsuperscript{22} However, in the event that restitution of the entity is fully or partially impossible because operations have been terminated and resumption would not be feasible, the claimant may request return of those specific property items that were in its possession at the time of its expropriation, or that property that replaced them.\textsuperscript{23}

\textsuperscript{18} Property Law, \textit{supra} note 2, § 6 (1). The Law is silent on the question of how a more detailed evaluation of such a change in products or services can be established. It is foreseeable that the courts will have to deal with that question in the future. A regulation on restitution of businesses provides some additional clarification. Verordnung zum Vermögensgesetz über die Rückgabe von Unternehmen vom 13. Juli 1991, 1991 BGBI. 1542.

\textsuperscript{19} Again, the Property Law does not specify the extent of such an exchange, although it is probable that it refers to the replacement of a product line.

\textsuperscript{20} See \textit{supra} note 10. The Property Law expressly states in § 6 (1a) that a "Berechtigter" with respect to business enterprises is the one whose assets have been affected by measures of expropriation set forth in § 1.

\textsuperscript{21} For a discussion of the procedural and adjudicative aspects of restitution applications, \textit{see} Section VII.

\textsuperscript{22} Property Law, \textit{supra} note 2, § 3 (1) (third sentence).

\textsuperscript{23} \textit{Id.} § 6 (6a).
In order to accelerate the restitution process and thus create a sufficient degree of legal security for investors, the Property Law provides that the claimant may apply for temporary possession (vorlaufige Einweisung) of a business enterprise. The authority will grant this request if the claimant can prove, by clear and convincing evidence, its entitlement to restitution and if no other party has also asserted a restitution claim. In case the claimant can produce substantial proof (Glaubhaftmachung) of its entitlement to restitution, temporary possession will be granted if:

(a) there is no indication that the claimants or persons appointed to operate the business will not properly execute the business operations; and

(b) in cases where needed renovations are necessary, if the claimant has plans for renovations that are likely to be successful.

A temporary possession application pursuant to (a) is deemed approved after a period of three months unless the authority has denied the application within that time. In all other cases, the authority has to render a written decision within three months of filing of a request for temporary possession.

Under the amended Property Law, the basis for temporary possession may be either a sale or lease contract between the claimant and the disposing party. Lease payments or purchase price payments are suspended until a valid and final decision on the claimant’s request for restitution has been rendered. Such payments become inapplicable once the enterprise has been finally restored to the claimant, and they become obligations if the claim is denied. The procedure of temporary possession forces the Treuhand to evaluate quickly whether an enterprise is not capable of reorganization, and therefore is not suitable for sale to third parties.

V. RESTITUTION CLAIMS IN CONNECTION WITH THE DISPOSAL OF PROPERTY

Once a restitution application pursuant to the applicable regulations has been filed, the disposing party is generally prohibited from trans-
ferring the affected property or from entering into a long-term lease for the property without the approval of the claimant.\textsuperscript{27} The only exceptions to this prohibition are transactions for the purpose of physical preservation of the property or from its continued commercial operation. The claimant is responsible, under these circumstances, for reimbursement of the costs connected with these measures.

The amended Property Law stipulates that if a restitution claim regarding property has been filed, whether timely filed or not,\textsuperscript{28} the disposing party generally has the power to enter into a sales contract or lease with respect to it. Before doing so, the disposing party must determine that no claim as defined in section 3 has been filed.

In the event a claim has been filed but has not yet been finally adjudicated, and no request for temporary possession has been filed, the Law permits the authorities responsible for restitution to dispose of the enterprise by the Treuhandanstalt (or other competent disposing party) in favor of an investor within three months if disposal: a) would create or secure jobs, b) would enable investments that enhance competition, or c) the claimant is unable to provide any guaranty that it will continue to operate the enterprise.\textsuperscript{29}

Requests for disposal of enterprises under this provision must be submitted before December 31, 1993. In addition, the request must be accompanied by substantial evidence that the purchaser or lessor has sufficient financial means to continue operations of the enterprise, or to renovate it. In the event the purchaser or lessor does not comply with its plan for the property within the first two years after the sale or lease, the claimant may apply for the transfer to be nullified and revoked. The authorities must approve such a request unless unanticipated economic factors excuse the purchaser’s or lessor’s non-compliance.\textsuperscript{30}

\textsuperscript{27} Id. § 3 (3).

\textsuperscript{28} The deadline for filing claims for restitution of property expropriated by the government of the former GDR was October 13, 1990. Claims based on confiscations during the Third Reich and for takings in criminal procedures had to be filed by March 31, 1991. Filing Decree, \textit{supra} note 15, § 3. However, even if the dates specified above have expired, tardy claimants may still be awarded restitution if the affected property has not been disposed of. Otherwise, the claimant is only entitled to claim the proceeds as compensation. Property Law, \textit{supra} note 2, § 3 (4). Consequently, a claim could be filed shortly before the conclusion of a sales contract between the Treuhandanstalt and investors. In that case, the authorities would determine the effect of the filing of the claim.

\textsuperscript{29} Property Law, \textit{supra} note 2, § 3 (6).

\textsuperscript{30} The Law does not specify how long the claimant has to file a request for nullification.
Furthermore, Section 3(a) of the amended Property Law enables the Treuhandanstalt or a public authority (öffentlich-rechtliche Gebietskörperschaft)\(^{31}\) to sell, let, or lease a business enterprise, piece of real estate, or building despite an already filed restitution claim if such action is for investment purposes. Investment purposes under this provision are:

1. In cases of land and buildings, if the sale, rent, or lease would:
   a) secure or generate jobs, especially if it involves further establishment of an enterprise that produces goods or services,
   b) meet a substantial housing need of the population, or
   c) create infrastructural measures required for such projects, and if the property is to serve such project and is in a satisfactory relationship with the desired purpose.\(^{32}\)

2. In cases of business enterprises, investment purposes are found to exist if its sale or lease serves the objectives stipulated in section 3, subsection 6 of the Property Law.\(^{33}\)

In order to afford sufficient protection for the claimant there are, however, some restrictions that apply to a disposal for investment purposes. The disposing party (Treuhandanstalt or the public authority) cannot enter into a sale or lease contract if a filed restitution claim or a claim for temporary possession is adjudicated in favor of the claimant before the consumation of the investment contract. In each case, the disposing party must inform the competent authority as well as any claimant known to it of its intent to sell, let or lease an object, and allow sufficient time for the claimant to respond before concluding the transaction. The disposing party also must consider whether a known claimant who, pursuant to a claim for temporary possession, has promised performance of investment measures equal or similar to the buyer’s, (or lessor’s or tenant’s) and whether the claimant shows substantial proof for execution of such measures. If so, the disposing party must take this into account in deciding whether to dispose of the property to such third party.

Unlike a disposal pursuant to subsection 6 of section 3, the underlying contract of a disposal for investment measures under section 3a of the Law must contain a condition by which the purchaser

\(^{31}\) Under German public law, these are local authorities such as cities, counties, or states that perform their affairs by means of autonomous administration but, in doing so, are subject to legal supervision by the higher authority.

\(^{32}\) Property Law, supra note 2, §3(1)(2).

\(^{33}\) Id. § 3(1)(2).
assumes the obligation to reconvey the asset if it does not comply with its plan for the property within the first two years, unless unanticipated economic factors excuse the purchaser's noncompliance.

Finally, this provision regarding the disposal of property for investment purposes is applicable only to contracts concluded on or before December 31, 1992.\textsuperscript{34}

A claimant has the option to choose monetary compensation instead of restitution.\textsuperscript{35} In case real property subject to a right of restitution has already been transferred in good faith by a disposing party, compensation may be granted by transferring real property of equal value to the claimant.

VI. DIVISION AND SEPARATION OF ENTERPRISES

During the 45 years of Communist economic management, previously expropriated enterprises were often joined to create large state-owned combines (Kombinate). Pursuant to the Treuhand Law of June 17, 1990,\textsuperscript{36} these combines, as well as all other government-owned enterprises, were transformed into corporations as of July 1, 1990. Since the return of the individual enterprises assimilated into these combines has proven to be a time-consuming task, section 6b of the amended Property Law provides a procedure for separation of the combines (Entflechtung)\textsuperscript{37} that allows a complete or partial division of combines into individual enterprises. This procedure seeks to accelerate and facilitate restitution and privatization of businesses. A request for "Entflechtung" of a combine can be filed by the claimant or the disposing party, and the competent authority will decide upon

\textsuperscript{34} Id. § 3a (9). It should be noted that, as long as a disposal can be initiated for investment purposes pursuant to § 3a of the amended law, § 3 (6) of the Law will not be applicable to sales, lettings or leasings of property. Since the latter provision deals only with disposals concerning enterprises, these cases will be affected by § 3a (9). This provides for yet another simplification and acceleration of the sale and lease of businesses by the Treuhandanstalt. Unlike § 3 (6) it can act without undergoing the lengthy administrative procedure set forth therein when selling or leasing companies for investment purposes.

\textsuperscript{35} At the time of writing, no further legislation has been enacted as to how the compensation will be computed. Thus all legal questions in connection with compensation are still open. All that is certain is that there will be a compensation fund. However, the amount and terms of a particular compensation remain unclear.

\textsuperscript{36} See supra note 13 and accompanying text.

\textsuperscript{37} "Entflechtung" has often been translated as "decartelization". The authors chose the term separation because it conveys the notion more efficiently of breaking up a large combine, which is not comparable to a cartel either legally or economically.
the request. Separation of a business must be permitted if the disposing party has demonstrated an uncontested right to the shares or membership rights of the part of the combine to be affected, and if the claimants have raised no objections.38

While separation is intended to facilitate restitution of property, the newly enacted Statute for Division of Enterprises Administered by the Treuhandanstalt of April 1991 (Division Statute)39 provides for the division of large business entities into smaller ones, thus making eastern German entities more marketable. Many potential investors have reportedly shown interest in acquiring parts of large entities but have been frustrated by legal hurdles.40 The amended Property Law allows the transfer of ownership of establishments or divisions of an existing stock corporation or limited liability company through a streamlined procedure. This can be accomplished in two ways:

a) the company, after being wound up but not liquidated, transfers its assets to at least two newly founded entities (Aufspaltung zur Neugründung); and

b) the company, retaining its legal identity, transfers only part of its assets to one or more entities that absorb certain operation units of the former combine (Abspaltung zur Neugründung).41

These provisions not only enable the Treuhandanstalt to sell the smaller enterprises, but also provide a vehicle for speeding up their modernization and for making them operate more efficiently.

VII. ORGANIZATION AND RULES OF PROCEDURE

The provisions of the amended Property Law are locally administered by the five new states and Berlin.42 The Law establishes higher and lower state offices (Obere und Untere Landesbehörden) for the

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38 Property Law, supra note 2, § 6b (2). The provision furthermore states that in all other cases, the authority shall render a decision upon exercising reasonable discretion.


40 German civil law does offer the possibility of breaking up a large enterprise into several legally independent units, but the assets cannot be transferred to the new units with one legal document. Instead each individual asset, such as machines or real estate, must be transferred through a separate document conveying ownership.

41 Division Statute, supra note 13, § 1.

42 Property Law, supra note 2, § 22. The five new states are: Mecklenburg-Vorpommern, Brandenburg, Sachsen, Sachsen-Anhalt and Thüringen.
resolution of unsettled property issues. Until all offices have been organized, the work will be carried out by the county administration or the municipal administration of independent towns and cities. In addition, a Federal Office for the Settlement of Property Issues was created under the Property Law in order to insure its uniform execution. With respect to restitution of business enterprises, separation of combines, temporary possession, and claims by the disposing party to take measures pursuant to section 3, subsections 6 and 7 of the amended Property Law, the sole jurisdiction lies with each State Office for Resolution of Unsettled Property Issues. However, when the disposing party proceeds with a disposal to an investor pursuant to section 3a, it may decide if the investment criteria of that section are satisfied and dispose of the property without prior permission of the authorities.

All claims under the amended Property Law are to be filed with the competent authority by submission of a petition form. Even though the deadlines stipulated by the filing decree have expired, claims filed after these deadlines are not barred. The amended Property Law is silent on the question of an expiration date for the filing of claims, but section 3, subsection 4 expressly states that a claim for restitution can be filed as long as the asset has not been disposed of. After that the claimant is only entitled to claim the proceeds of the sale as compensation.

The venue for claims affecting assets under state administration is with the authority in the district where a claimant, or its heir, last resided in the former GDR. This also applies to assets that were confiscated and nationalized. In all other cases, the responsible authority will be the one in whose jurisdiction the asset is located.

The amended Property Law now contains provisions designed to provide for an amicable settlement of claims for restitution by agreement between the claimant and the disposing party. The authorities are obliged under the Law to work towards such settlements at all times. Parties may also agree to arbitrate issues concerning the restitution of business enterprises or temporary possession. The possibility of settlement by arbitration will hopefully help to lighten the
burden on the courts and accelerate the proceedings. However, arbitration is not permitted if it would involve a claim for restitution or separation of a business enterprise that would affect third party interests.\textsuperscript{46} In this case, the competent authority is obliged to inform third parties whose legal interests may be affected about the restitution application by sending them a copy of the petition form and its enclosed documents. Furthermore, the authority is obliged to consult with the affected party regarding the procedure.\textsuperscript{47}

The party filing a claim under the provisions of the amended Property Law is entitled to receive from the authority in writing any information necessary for enforcement of its claim. A showing, by substantial evidence, of entitlement to restitution must be made in support of the information request. If information has been requested and received, the competent authority cannot render a decision regarding the original claim until one month after receipt of the information. The Law does not specify the maximum amount of time within which a decision must be rendered.

A decision is enforceable and final one month after issuance unless the claimant files a formal protest in writing within that time.\textsuperscript{48} If, upon protest, a decision is reversed or amended, and thus affects a third party, then the third party has a right to be heard before a ruling on the protest is rendered.

The party adversely affected by the decision or the formal response of the authority to a protest may seek judicial review in a proper court of law, whose decision is not subject to further challenge.

\textsuperscript{46} Id. § 30 (2) (second sentence), § 31 (6).
\textsuperscript{47} Id. § 31 (2).
\textsuperscript{48} Property Law, supra note 2, § 33 (5) and § 36 (1). A formal protest procedure is excluded regarding decisions by the state authority on measures pursuant to § 3 (6), restitution of business enterprises and their separation as well as temporary possession.