HEUKING KÜHN LÜER WOJTEK

Doing Better Business in Germany

Direct Investments
Commerce and Trade

Initial Orientation and
Guidance for Clients and
Legal Counsel Abroad

LAWYERS AND TAX ADVISORS

HEUKING KÜHN LÜER WOJTEK

Doing Better Business
in Germany

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Doing Better Business in Germany

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Preface to the Seventh Edition

Once again, "Doing Better Business in Germany" has been carefully updated and significantly extended to additional legal sectors, including tax fraud and customs. Members of the firm Heuking Kühn Lüer Wojtek have compiled this guide for foreign entrepreneurs and legal, tax and business advisors. It works for investors as much as for manufacturers and developers. It is further useful for all businesses involved in commerce and trade, distribution, licensing, franchising, and just about any other entrepreneurial activity in Germany. It covers practical and in-depth information on a broad range of legal issues shaping today's business environment in Germany.

We hope you will enjoy your reading.

The German Civil Law System – a Quick Overview

The legal systems in most of the currently twenty-eight continental jurisdictions of the European Union (EU) are based on Roman civil law principles, as opposed to the common law system of the United Kingdom (and, for that matter, the United States of America and other common law jurisdictions). The EU, as well as the globalization of commerce and trade in general, have harmonized the laws and practices in Europe. Nevertheless there are still a number of principal differences in local European laws, which you should be aware of.

These differences have multiple practical consequences, not only in terms of the legal forms in which businesses are organized, but very importantly in respect of such matters as contract law, fair competition, employment law, and, of course, dispute resolution procedures. Some of these differences are quite fundamental, but easy to understand and to remember if you have advance information available.

Much confusion emerges at times from a "faithful" but, in fact, poor translation of a given legal term. Literal "translations" often fail to communicate the true meaning, thereby leading to avoidable misunderstandings. When you come from a common law country, be aware of terms such as "agency," "trust," "board," "manager," "termination for cause," "notary," "chamber of commerce," "federal and state courts" and the like as they do have different meanings in Germany.

The German civil law system is largely cast in a number of major federal codes (such as the Civil Code, Commercial Code, Tax Code, Criminal Code, the Codes of Civil, Criminal, and Administrative Procedures). Some of these are well over 100 years old, revised when necessary, and still providing a stable and deeply structured backbone of the law. Other parts of our law are set forth in a large number of principal statutes regulating, again on a federal, nationwide level, a large number of important private and commercial sectors (including, e.g., the Law Against Unfair Competition, the Copyright, Patent, and Trademark Acts, the Federal Building Act, the major corporate acts regarding the various legal forms of doing business, and many others). In addition, there are a large number of laws, regulations and ordinances on both a federal and state level (federal or state – depending on the constitutionally allocated jurisdictional competence) which provide fine tuning or specific rules in a given legal sector. Cultural affairs (including education, arts, media, broadcast), as well as some locally relevant issues (i.e., some construction and zoning aspects), are more or less a matter of State jurisdiction in the 16 German States *(Land*, pl. *Länder)*, allocated to 16 State parliaments and governments. That has historically caused some regulatory confusion and "particularism" in some business sectors (including media regulation and property development). Last but not least, many daily business operations are governed by local municipal regulations (such as regulations governing local trade licenses *(Gewerbeanmeldung)*, Sunday and holiday business operation permits, etc.).

With that kind of solid statutory support to build on, it is no wonder that traditional civil law contracts are relatively short, and focused on only matters that are special to a given legal relationship. The rest is often a matter of relying on statutory rules and fine tuning. On the other hand, in international business relationships, long form agreements make much sense in order to create, as much

as possible, a comprehensive set of rules for a given international relationship that is readily understandable for the contract parties involved. This applies, of course, regardless of the agreed applicable law or the law applicable under local conflict of laws rules.

Where German laws revert to "undefined legal terms" or "general legal clauses" (which are intentionally unspecific and subject to interpretation, such as the terms "reasonable," "normal course of business," "good cause"), the law is interpreted and developed by the Federal, State and local courts. Legal commentaries of academic jurists or practitioners provide additional authority or supplementary guidance.

Civil law jurisdictions often have highly specialized courts in civil and commercial, criminal, public administration, labor, social, tax, and constitutional matters. Many German Civil Courts even maintain special patent, trademark, copyright, and unfair competition benches in trade and regular civil disputes. Further, there are, in principle, three procedural instances in each of these sectors (the second and third instances predominantly for review of matters of law, only). First instance cases are heard by the local or regional courts, depending on the value in controversy. Second instance (appeal) cases are heard by the appeal courts, and the legal review in the third instance takes place at the Federal Courts of Justice specializing in civil and criminal, public administration, labor, social, and tax matters. Final recourse may be available to the Federal Constitutional Court and the European High Court. Most judges work in a civil service status. Arbitration and mediation provide well-developed supplementary dispute resolution options. For details please see the relevant chapters below.

Under the German Code of Civil Procedure, a complaint in a court action must contain a full and detailed statement of facts, as well as detailed offers of evidence to support the alleged facts (the offer of evidence may involve reference to a specific document, the name of a witness, the request to the court to obtain an expert opinion). There is no pretrial discovery, each party presents its own knowledge of the facts, and there are only very limited means of obtaining information or documents from the other party. It is the court that hears named witnesses and evaluates written evidence, and this concerns only the disputed parts of the facts presented by either party. This limitation of the evidence taking procedure helps to achieve quick and relatively low-cost dispute resolution. Officers and directors are considered "party" to a lawsuit and do not qualify as witnesses. Regular court proceedings take about 9 to 12 months in each instance, considerably longer at the Supreme Court level. Litigation costs are composed of statutory lawyers' fees and the court costs. Both are regulated by statute. The amount depends on the value of the case (fees and costs are determined on the basis of the relevant graduated fee schedules). The losing party pays all costs and legal fees (including the other party's costs and the court fees), in each case limited to the statutory fees (as opposed to higher fees based on possibly agreed hourly charges). Any portion of contractually agreed legal fees that exceeds the statutory minimum fees does not qualify for reimbursement to the winning party. As concerns statutory lawyers fees and court costs, ordinary litigation is comparatively inexpensive. Lawyers may ask their clients to agree that their fees are based on hourly rates (separate written agreement required), which may result in higher fees than the minimum statutory fees. Hourly fees charged by large firms for partner time range normally from €300 to €600.

Injunctive relief is available in quick injunction procedures. A prior cease and desist request in a letter form is normally required. It offers the other party an out-of-court opportunity to eliminate the infringement or violation through a binding cease and desist undertaking which must be secured by a penalty clause. Such prior request letter is not required in situations where a prior warning would jeopardize the enforcement of an injunction, or, for instance, an attachment order regarding counterfeit products. A case qualifies for injunctive relief if quick summary court assistance is required urgently. If the plaintiff has known the relevant facts for more than about one month, the request would

not normally qualify (some courts accept somewhat longer periods). Ex parte injunctions (rendered without prior oral hearing) are possible, they are subject to review based on an "opposition" filed by the defendant, in which case the court will hear the case in an oral hearing. Injunctions rendered after oral hearings are subject to one appeal to the next higher court.

Although German lawyers have traditionally practiced in relatively small offices, and clients have traditionally retained lawyers mainly for dispute resolution purposes, the past 25 to 30 years have seen a significant change of the profession towards legal planning and advisory services ("legal architects"). In addition to the majority of small legal practices, there are large law firms which are internationally organized, as well as large independent German firms such as Heuking Kühn Lüer Wojtek. It is one of the largest independent German firms offering full legal and tax services out of ten offices.

Notaries are members of a separate legal profession. In some States, notaries can be lawyers at the same time, in other States, a notary cannot have any other profession, and in still other States, Notaries are civil servants. Notarization of a transaction is required in certain instances, including mainly corporate, real property and matrimonial matters. The notary assumes responsibility for the formal and substantive legal effectiveness of the contract or transaction.

Again, for details please browse through the relevant chapters below. Enjoy your reading.

I. Legal Forms of Doing Business

To do business in Germany, entrepreneurs and investors have several options in terms of the legal forms of business available under German and EC law. There are (i) the sole proprietorship, (ii) the professional partnership, (iii) the general partnership, (iv) the limited partnership, (v) the limited liability company, (vi) the stock corporation, and (vii) the European company. Corporate law is also influenced by the jurisdiction of the European Court of Justice, for instance regarding the cross-border relocation of corporate entities. A principal distinction in German company law is the division of legal forms into those which are considered to be "legal persons" and others which are not. In some aspects, however, this distinction is not carried out in all legal consequences. The most important legal forms for international activities are the following:

1. Partnerships

a. Civil Law Partnership (Gesellschaft bürgerlichen Rechts – GbR)

Civil law partnerships are governed by Secs. 705 et seqq. of the German Civil Code (BGB) and serve only non-commercial purposes. The formation is quite simple. There are no material formalities to be observed. If two or more partners agree on a partnership agreement, the civil law partnership is established. Partner contributions to the partnership are not required. Partners can be natural and legal persons in any conceivable form or combination. Only partners – no third parties – are in charge to manage and represent the partnership. Generally, the partners are jointly entitled to manage the partnership, unless a single or more partners are appointed to do so. In the latter case, all other partners are excluded from management and the power of representation. All partners can supervise the actions of the managing partners. Civil law partnerships are quite popular for practices of self-employed professionals, such as lawyers, tax advisors, auditors, doctors, architects, real estate agents, etc.

The civil law partnership as such is not a "legal person." Over the years, however, its ability to exercise rights and obligations in its own name became legally recognized. A partnership has the legal ability to enter into contracts, to be owner of real estate and to sue third parties under its own name and also to be sued by third parties. The partnership and all partners are jointly and severally liable for the partnership's obligations.

b. Professional Partnership *(Partnerschaftsgesellschaft – PartG)*

The professional partnership is similar to the civil law partnership but it serves the special needs of self-employed professionals. The partners have unlimited personal liability just for claims based on their own professional work.

On July 19, 2013, the reform of the PartG created the possibility to limit the liability up to the value of the assets of the partnership, if special professional indemnity insurance is stipulated. In this case, the professional partnership is a "professional partnership with limited professional liability" *(Partnerschaftsgesellschaft mit beschränkter Berufshaftung – PartGmbB)*.

c. General Partnership *(Offene Handelsgesellschaft – OHG)*

The OHG is similar to the civil law partnership but it serves business purposes and carries out trade. It is, therefore, a commercial entity within the meaning of the Commercial Code *(Handelsgesetzbuch – HGB)*. In addition to the conclusion of the partnership agreement, registration with the commercial register is required as the only formal legal requirement. Registration must in- clude the names of the partners, the name of the partnership, and the business address. The OHG comes into legal existence upon signing of the partnership agreement. All of its partners have unlimited personal liability for all obligations and debts of the OHG.

d. Limited Partnership *(Kommanditgesellschaft – KG)*

The legal form of a limited partnership is popular for small and medium-sized businesses which require operational capital from investors who do not wish to be liable beyond their capital investment. In general, the legal provisions governing the OHG also apply to the limited partnership. The Commercial Code contains additional provisions reflecting the nature of the limited partnership.

In addition to one or more general partners with unlimited liability, a limited partnership has at least one partner with limited liability – the "limited partner" *(Kommanditist)*. The liability of each limited partner is limited to its registered contribution to the partnership's capital. Once the limited partner has paid up its contribution, neither the KG nor the creditors of the KG may claim any further payments from the limited partner. As is the case with the OHG, the KG as such is not a "legal person" but can also enter into agreements under its own name, can sue and be sued in court. Only the general partner – not the limited partner – is responsible for the management of the KG and represents it towards third parties.

The formation and registration of a limited partnership is similar to that of a general partnership. There are no general legal requirements regarding the minimum amount of capital or the maximum number of partners. It comes into existence as soon as the partnership agreement is executed and the limited partnership starts doing business. The limitation of liability of the limited partner requires registration with the commercial register, however.

e. Combination of Limited Partnership *(KG)* and Limited Liability Company *(GmbH) (GmbH & Co. KG)*

The GmbH & Co. KG is a hybrid legal form in which a limited liability company (GmbH) serves as the general partner of the partnership. This hybrid form is legally considered to be a limited partnership. The specialty of this construction is that the liability of all persons involved is limited: The persons listed as limited

partners are only obliged to pay their registered capital contribution and have no liability beyond that contribution. Although the general partner *GmbH* as such has unlimited liability, the legal form of the GmbH provides for the limitation of liability of its shareholders; the shareholders' obligations are limited to paying the individually subscribed share capital (see below). The *GmbH & Co. KG* provides a unique way to limit personal liability of the participating parties. All shareholders are, however, jointly liable to pay up any registered or subscribed but unpaid capital.

2. Corporate Entities

Any German or foreign company, entrepreneur, or investor can also acquire or establish a German company in the legal form of a limited liability company *(GmbH)* or a (stock) corporation *(AG)*. There are no legal restrictions regarding the acquisition of corporate entities by foreign parties. Restrictions may apply only if provided for in the target company's articles of association, or if the business conducted by the *GmbH* or *AG* is subject to regulatory restrictions.

Additionally, there is the European legal vehicle of the Societas Europaea, which can be registered in Germany as well.

a. The (Private) Limited Liability Company *(Gesellschaft mit beschränkter Haftung – GmbH)*

The limited liability company is an incorporated registered business entity within the meaning of the Commercial Code, it is a "legal person." It provides for limited liability of its shareholders. Its management may be composed of shareholders and non-shareholders. The activities of a limited liability company are not restricted to mercantile or commercial purposes. It can also conduct not-for-profit (charitable) and other non-commercial activities.

The *GmbH* is the most popular German investment vehicle chosen by foreign investors. Its formation and operation are governed by the Act on Limited Liability Companies *(GmbH-Gesetz – GmbHG)*. The *GmbH* requires a minimum share capital of €25,000 of which €12,500 must be paid up before the company can be registered with the commercial register. A limited liability company can be established by one or more persons or companies by adopting the articles of association *(Satzung)* before a notary public.

The company exists legally as soon as it is registered with the commercial register. It may start doing business before registration, but until registration each shareholder is personally liable for debts incurred by the company. The limited liability company, basically, has two corporate bodies: the shareholders' meeting *(Gesellschafterversammlung)* and the registered manager(s), namely one or more general managers *(Geschäftsführer)*. A third corporate body, the supervisory board, is mandatory only if the *GmbH* has more than 500 employees.

Capital contributions are paid up in cash but may also be made in kind if the articles of association state exactly the asset to be contributed and the monetary value of such capital contribution in kind. The founding shareholders are required to prepare a special report demonstrating the adequacy of the valuation of the contribution in kind.

The transfer of shareholding in a limited liability company requires notarization. Its shares cannot be traded at the stock exchange. On November 1, 2008, the farthest-reaching reform of the Act on Limited Liability Companies since its existence entered into force and brought important changes *("MoMiG")*. The *MoMiG* introduced the possibility to acquire shares in a limited liability company in good faith from a person that is not (or no longer) a shareholder of the company if such person is (still) registered as shareholder with the commercial register. Furthermore, the limited liability company may now relocate its head office to a jurisdiction that is different from that of its registered office.

The *MoMiG* established, in addition, a modified form of a limited liability company, the so-called "enterprise company (with limited liability)" – in German *"Unternehmergesellschaft (haftungsbeschränkt)."* This company requires for its registration a minimum registered capital of €1.00. The registered share capital has to be paid up completely and capital contributions have to be made in cash only. The company has to observe certain restrictions with respect to the distribution of profits.

b. (Stock) Corporation *(Aktiengesellschaft – AG)*

Like the limited liability company, a (stock) corporation is also an incorporated business entity within the meaning of the Commercial Code and a "legal person." Formation and operation of corporations are governed by the Corporation Act *(Aktiengesetz)*.

A corporation must maintain a minimum share capital of €50,000. The share capital must be fully subscribed; and at the time of formation at least 25% of the subscribed equity capital must be paid up.

Shares of a corporation must have a minimum par value of €1.00. They can be issued without par value but the value allocable must be at least €1.00.

A German corporation has a three-tier structure. Bodies of this structure are the shareholders' meeting *(Hauptversammlung)*, the supervisory board *(Aufsichtsrat)*, and the board of directors *(Vorstand)*. The latter two bodies are strictly separate. It is not permissible for any individual to serve on both boards of the same corporation. Members of both boards have to be appointed before the corporation can be registered with the commercial register. The supervisory board consists of at least three members. It appoints and dismisses the members of the board of directors, represents the corporation in disputes between the corporation and members of the board of directors, and has the duty to examine the balance sheet, income statement, and further documents composing the annual financial statements. The supervisory board advises the board of directors on essential business decisions. The board of directors is responsible for the management of the corporation and represents the legal entity towards third parties.

The tasks of the shareholders' meeting include, in particular, the election and removal of members of the supervisory board, the determination of the distribution of profits, and the approval of increases or decreases of the share capital.

Shares of a corporation are freely transferable; no notarization of the transfer agreement is required. Subject to certain statutory requirements, shares of a corporation can be traded at the stock exchange. Shares can be issued as bearer shares *(Inhaberaktien)* or registered shares *(Namensaktien)*. The corporation may also issue non-voting preference shares *(Vorzugsaktien)*. Bearer shares need not be documented by share certificates. The transfer of registered shares requires entry of the transfer in the shareholders' register of the corporation.

c. The European Company *(Societas europaea, SE)*

The SE is a stock corporation, the legal structure of which is similar to the German AG as described above. An SE, however, can be registered in any Member State of the European Union. It may either comprise a two-tier system (supervisory body and management body) or a one-tier system (administrative body) depending on the form adopted in the statutes.

The SE is registered with a commercial register of a Member State. An EU-wide register does not exist, but each registration is published in the Official Journal of the European Union.

SEs may be created in four different ways:

- merger of national stock corporations of Member States, provided that at least two companies are from different Member States;
- creation of a "holding SE" between national stock corporations or limited liability companies of Member States, provided that at least two companies

are from different Member States or a company that had, for at least 2 years, a subsidiary or a branch in another Member State;
- creation of a "subsidiary SE" between national companies, firms or other legal bodies of Member States, provided that at least two companies are from different Member States or a company that had, for at least 2 years, a subsidiary or a branch in another Member State or
- conversion of a stock corporation of a Member State, provided the company had, for at least 2 years, a subsidiary in another Member State.

The SE must have a minimum subscribed share capital of €120,000. National laws can provide for higher requirements.

National laws govern further details of the SE, in addition to, particularly, Council Regulation (EC) No 2157/2001[4] of October 8, 2001 on the Statute for a European company (SE).

3. Cross-Border Relocation of Corporate Entities within the EU

a. The SE

According to Article 8 SE Council Regulation, the SE can be transferred from one Member State to any other without liquidation in one and/or reestablishment in the other.

b. Other Corporate Entities

Any other company of a Member State of the European Union can be transferred to another European Member State, provided the Member State of origin and the host Member State grants national companies the right to convert, according to a recent decision of the European Court of Justice (Case VALE, C-378/10). The company has to actually pursue an economic activity in the host Member State, however.

The relocation follows specific rules which are, to a certain extent, still subject of discussion. In general, the same rules and requirements that apply to national companies of the Member State of origin and the host Member State in the case of a domestic conversion also apply in the case of cross-border conversions. The two national laws apply consecutively to the legal operation of the cross-border conversion. In particular, the following formalities are to be observed:

- The shareholders must raise and adopt the share capital in accordance with the requirements of the target jurisdiction.
- The shareholders and the management of the company have to apply to the commercial register of the target seat of the company in accordance with legal requirements of the target jurisdiction.
- Only after all formalities are settled at the target seat, the commercial register of the abandoned jurisdiction is to be instructed to cancel the former registration.

Useful link: · www.ihk.de

II. Mergers and Acquisitions

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The term "Mergers and Acquisitions" ("M&A") describes transactions where corporate entities or business units are acquired by other legal entities ("M&A transactions"). Whereas reasons for purchasers to enter into M&A transactions are, for example, entrepreneurial growth, the wish to gain access to new markets and/or the expansion of the product portfolio by realization of synergies, on the sale side, M&A transaction are often driven by the seller's intention to realize goodwill, strategic reasons or succession plans.

The last years in the M&A market were very active, and despite unexpected economic developments in 2017, in particular Brexit and the outcome of the US presidential elections, further growth is expected. The most active industry sectors regarding M&A transactions in Germany were, in 2016, the service sector, IT, industrial goods/engineering, pharma/life science, energy supply, and automotive.

Foreign investments play an important role in the German M&A market. Statistics show that more than half of the acquisitions of companies incorporated in Germany are effected by foreign investors.

1. General Background of M&A Transactions in Germany

In Germany, large-volume transactions follow international standards whether being public or private (PE/financial or strategic) M&A transactions. This applies as far as the whole (auction) process is concerned and in particular as regards due diligence, agreements and financing, and all this mostly in the English language. On the other hand, medium-sized, often family-owned companies, make up the majority of M&A transactions. In this scenario, when considering how to approach a potential seller, the following aspects have to be taken into account by the purchaser: Private owners from the German *"Mittelstand"* are often emotionally attached to their businesses, and it is therefore important to them to hand over their lifework into good hands. In addition, if the company is family-owned or privately owned, the owner is often not familiar with complex M&A transactions (and this may sometimes even apply to its advisors). In such a situation, an aggressive approach is most likely not adequate, but the purchaser should rather choose an empathetic approach in order to get the seller "on board." This may have consequences in all phases of the transaction. The seller may be discouraged by an – at least in his view – overly complex due diligence process, based on extensive due diligence checklists and being conducted in different rounds and with complicated Q&A sessions so that the purchaser will need to proceed cautiously to obtain the required information. To some extent, the above may also apply to M&A agreements. Even though internationally applicable standards are also applied to these kinds of M&A agreements, M&A agreements governed by German law are often shorter and less detailed, and a potential seller may therefore be deterred if the purchaser presents an overly elaborate first draft of the purchase agreement and the seller may be reluctant to give representations and warranties to an extent customary in M&A agreements subject to U.S. or UK law. It is therefore crucial that the parties, supported by their advisors, closely collaborate in order to get the deal done.

A

2. M&A Agreements

M&A transactions are governed by general civil law provisions and, depending on the parties involved and the volume of the transaction, specific provisions such as merger control law, foreign trade law, or capital market law provisions. Core element of an M&A agreement is risk allocation. Whereas the seller wants deal certainty, the purchaser wants to be protected to the greatest extent possible against insecurities, adverse effects on the target company and the like. As will be described in detail below, this is reflected in the core provisions of an M&A agreement. Whereas the market in Germany is currently rather a seller's market, the concrete contractual arrangements depend very much on the bargaining power of the parties.

a. Signing and Closing; Conditions Precedent; MAC

Traditionally, in Germany, M&A agreements were signed and completed on the same day whenever possible, with the payment of the purchase price being the only condition precedent applicable. This principle has changed, and also M&A transactions subject to German law nowadays often provide for a two-step approach, with signing bindingly establishing the obligations between the parties, and closing meaning the completion of the formerly signed agreement.

Closing may be subject to certain conditions precedent *(aufschiebende Bedingungen)* to be fulfilled. Legally binding conditions precedent are the obtaining of regulatory approvals, in particular merger clearance *(Kartellfreigabe)*. Further typical conditions precendent are the granting of approvals by shareholders, partners, the target company itself, intra-group board approvals (see also III. 2 below). Further, third-party consents may be specified as condition precedent, e.g., the consent to the transfer of certain material agreements in case of an asset deal or the waiver to make use of a change-of-control provision in case of a share deal.

Another condition precedent often demanded by a purchaser is a so-called MAC clause (material adverse change clause), in order to be protected against a deterioration of the target company in the interim period between signing and closing. By way of a MAC clause, the risks of adverse events materially affecting the target company's business – which mostly do not fall into either party's sphere – are allocated to the seller by granting the purchaser a rescission right in case such a material adverse change occurs. Whereas in the US, the use of MAC clauses is very common, in Germany it is still rather an exception (other than in PE transactions). In case MAC clauses are used in German law agreements, the clauses are usually precisely defined in order to prevent that the purchaser may misuse such clauses to enter into renegotiations, or to easily rescind the agreement.

b. Pricing Mechanism – Locked-Box vs. Purchase Price Adjustments

The determination of the pricing mechanism plays an important role in M&A agreements, as such provisions, to a great extent, determine the time when transfer of economic risk occurs *(Übergang des wirtschaftlichen Risikos)*. Common mechanisms are the locked box mechanism and an adjustment of the purchase price, based on completion accounts.

The locked-box mechanism provides for the determination of a fixed value date, the locked-box date, and an agreement of a fixed equity price as of such date. Under this principle, the economic risk passes to the purchaser as of the locked-box date. Any profits or losses of the business after the locked-box date will be attributable to the purchaser, even though the seller is still in control. Consequently, the purchaser has to be protected against any leakage of value in the time period between the locked-box date and the closing. The parties often intensively negotiate what is to be considered a leakage and which actions are to be exempted as permitted leakages. On the other hand, the seller usually wishes to be compensated for profits made by the target company during such period, and may therefore request a specially determined rate of interest to be paid, especially if the target company is profitable. The locked box is considered as seller-friendly since it grants certainty on the determination of the purchase price. The advantage for both parties is that it is quicker and less expensive since no closing accounts need to be established.

In contrast, if the parties agree on a purchase price adjustment mechanism, the final purchase price is not yet known at completion. The parties agree on a preliminary purchase price to be paid at closing, which is subject to adjustments based on completion accounts. The economic risk for the period between signing and closing is allocated to the seller. Common methods for adjustments are working capital adjustments and net debt adjustments. The main focus of respective negotiations concerns the agreement on the financial definitions on which the

adjustment mechanism is based. Another important issue is the determination of the accounting principles on the basis of which the closing accounts are to be established and, in case of dispute, to be applied by an independent expert, acting as an arbitrator. Purchase price adjustments are generally favored by purchasers since they are more precise and take into account the development of the financial situation in the period between signing and closing.

Different from in the US, where the application of a locked-box mechanism is rather an exception, the mechanism is popular in Germany and is on the rise in Europe.

c. Warranties and Indemnities; Remedies; Limitation of Liability

Core provisions of an M&A agreement, and main focus of the negotiations, are the contents and scopes of warranties and indemnities, remedies and limitations of liability. Since German law does not provide for provisions specifically designed for M&A agreements, and is therefore considered to provide for inadequate risk allocation, in the vast majority of M&A transactions, German statutory law is explicitly excluded; instead, M&A agreements as such provide for an elaborate liability system.

The seller customarily gives specific warranties which are unrelated to faulty behavior regarding past and present facts. These concern the corporate status, the business and its operations, assets, liabilities, and earnings of the target company, financial statements, pending or threatened litigation, etc. The scope of warranties also depends on the characteristics of the target company, as well as due diligence findings, and determined by the bargaining power of the parties is in the end. Whereas warranties cover abstract risks, indemnities are granted for certain risks identified during due diligence

The liability of the seller for breaches of warranties is usually capped at a certain percentage of the purchase price. A limitation to 10% to 50% is quite common, whereas regarding fundamental warranties, like the corporate status or title to the shares, it is common standard that the liability is capped at the purchase price. With regard to indemnities, no general standard exists, but sellers will be reluctant to grant indemnities with no caps at all, so that at least the purchase price usually builds a cap for indemnities.

In order to prevent small, trivial claims, M&A agreements usually provide for a so-called "de minimis amount," constituting a minimum amount necessary to be reached for individual claims to be raised. In addition, parties often agree on so-called thresholds, or baskets, stipulating that the seller is only obliged to pay damages if certain thresholds are met. Baskets may be designed either as deductibles baskets, where the seller will only be liable for damages exceeding the basket amount ("excess only" – *Freibetrag*), or thresholds, where the seller will be liable for any and all damages once the threshold is reached ("first dollar" – *Freigrenze*). In Germany, thresholds are commonly used, and the use of deductibles is an exception. The value of baskets is commonly between below 1% of the purchase price, but may also be about 3%. Regarding indemnities, usually no de-minimis or baskets apply.

Parties usually also exclude the statutory limitation provisions and provide for specifically agreed time limitations during which a claim for indemnification must be asserted. Time limitations commonly range between 12-36 months, but as a general rule, the purchaser will require two balance sheets to be able to evaluate whether warranty claims can be raised. Fundamental warranties are often granted for a longer time (5 years+), and specific representations, such as reps on tax and environmental issues are often linked to statutory limitation periods.

Limitations of liabilities do not apply in case of intentional behaviour *(Vorsatz)* or malice *(Arglist)*.

d. Seller's and Purchaser's Knowledge

In order to limit its liability, the seller will try to only give the warranties to its "knowledge" or "best knowledge," whereas the purchaser will not want to accept

any qualifications to warranties. Both, the extent of knowledge qualifiers and the definition of knowledge are often heavily negotiated between the parties. The definition of knowledge differentiates, inter alia, between active knowledge, i.e., what is actually known, gross negligent lack of knowledge (i.e., what should be known) and constructive knowledge, i.e., deemed knowledge, with again different variations of this definition (e.g., knowledge that would have reasonably been obtained after due enquiry with certain individuals or in the position of the knowledge representative). Another point of discussion is usually who will be considered as a knowledge representative.

On the other hand, the seller will not be willing to pay damages in case the purchaser is aware of a breach of a warranty or the underlying facts of such breach, and will therefore argue that any claims purchaser has knowledge of will be excluded. In this context, the most relevant question is what constitutes knowledge. Seller will argue that any information made available to the purchaser, irrespective of whether in writing or orally, will constitute purchaser's knowledge. Purchasers are, however, at most times reluctant to accept an attribution of orally provided information. Respective provisions exist in all conceivable varieties. A compromise solution would be, e.g., that any information made available during due diligence in a virtual data rooms, and possibly other information provided in writing, constitutes knowledge. The above knowledge definition applies in this context as well.

Usually, the same knowledge definitions apply to seller and purchaser.

3. Formal Requirements

a. Form Requirements, in Particular Notarization

Under German law, contracts may generally be concluded without special form requirements. M&A agreements require notarization (as explained below in detail) in the following situations, however:

- Share sale transfer agreements regarding the transfer of shares in a limited liability company under German law *(Gesellschaft mit beschränkter Haftung – "GmbH")*.
- Asset sale and transfer agreements if the seller transfers all of its assets.
- Asset sale and transfer agreements involving the transfer of real estate and/or shares in a *GmbH*
- Sale of interest in a limited partnership *(GmbH & Co. KG)* when selling both, the general partner, a *GmbH*, and the interest of the limited partner.

Notarization means that the agreement is read out aloud in the presence of a notary public and the parties (or their lawyers on the basis of a special power of lawyer). If the notarization requirement is not complied with, the respective contract is not enforceable. The notarization requirement applies to the entire transaction, including all related terms and side agreements *(einheitliche Beurkundung)*, and the failure to notarize e.g., a side agreement may render the whole transaction null and void.

The formal invalidity of a non-notarized agreement regarding the sale and transfer of shares in a GmbH can be cured. With respect to shares in a *GmbH*, the agreement stipulating the obligation to transfer shares becomes effective once the agreement on the actual transfer of shares is notarized. Due to this principle, it is possible to provide in multi-jurisdictional transactions, if the parties do not wish the agreement to be subject to German law, the share transfer deed stipulating the in rem transfer is subject to German law and notarized, and the underlying agreement which creates the obligation to transfer is subject to a foreign law.

b. Approvals and Consents

The closing of the transaction may be subject to merger clearance, depending on whether certain revenue thresholds are met. Further, in case of the acquisition of a target by an acquirer who is not domiciled in a Member State of the European Union, the transaction may be prohibited if it constitutes a danger to public policy or public security, although the scope of application of this

provision is limited to exceptional cases. Regulatory supervision requirements apply to banks and insurance companies.

The sale and transfer of participations in enterprises may require the approval by either the partners/shareholders and/or the enterprise itself. The articles of association of the target company may stipulate further requirements, e.g., provide for transfer restrictions such as consent requirements or pre-emption rights, which is often the case in companies with a personalized shareholding structure. Board approvals may also have to be obtained.

4. Public M&A

The term "public M&A" refers to acquisitions of companies listed on the stock exchange. The main legal provisions for public acquisitions are set out in the German Securities Acquisition and Takeover Act *(Wertpapiererwerbs- und Übernahmegesetz – "WpÜG")*. The procedure for public acquisitions is very strict and set out in detail in the *WpÜG*. The structuring of a public M&A deal is very complex. One core provision of takeover law is that an acquirer is obligated to make a mandatory offer if he intends to acquire, or has acquired, 30% of the votes in a listed company, either itself or by acting in concert with other parties.

5. Tax Issues

M&A transactions require careful advance tax planning. The structuring of a transaction is often driven by the aim to achieve a tax-optimized structure. Companies (still) have certain flexibility in arranging their taxable income in a manner helping to reduce the tax burden (e.g., by means of tax pooling *(steuerliche Organschaft)*, the use of loss carry-forwards, etc.). In any event, a suitable transaction structure should be developed and continuously reviewed by expert tax counsel.

III. Joint Ventures

While starting a new business involves typically the task of procuring capital, there is often a demand for sharing other production factors as well. This applies all the more during periods when capital can be obtained at low cost. Running and organizing a business in the form of a joint venture enables the parties to leverage synergies and to bundle forces by sharing know-how, experience, and any other production factor. Unsurprisingly, a new trend can be seen when looking at the formation of joint ventures involving start-ups as well as experienced and established market participants. Apparently, the business form of a joint venture allows the parties involved to exploit their common interest and complement one another's abilities. The parties' intersecting set of ambitions is accompanied, however, by the parties' very own interests pursued outside of the joint venture. Hence, founding and structuring joint ventures require sensitive accounting for the correlation of its natural benefits with its typical risks. Considering the fact that the economic structure in Germany consists of a strong layer of medium-sized companies, there is a wide range of potential companies to partner with in Germany. This promising business environment is supplemented by a legal system that allows founding, structuring, and operating joint ventures in a very controlled and foreseeable manner.

1. Basic Legal Situation in Germany

The German legal system is well prepared for founding and operating joint ventures. There are several internationally established rules and customs regarding the organization and implementation of joint ventures. Those rules apply to the German system as well. The principle of distinguishing between a contractual collaboration (contractual joint venture) and a cooperation based on a share of equity (equity joint venture) is mainly a result typically derived from economic and strategic considerations. The German legal system maps this distinction by providing the parties a legal framework involving several contractual solutions as well as a broad range of legal forms to implement a corporate entity

(Kapitalgesellschaft). A contractual joint venture has no organizational independence. Instead, it provides a common framework of rights and obligations to carry out a given project in accordance with the agreed terms. In contrast, a German corporate entity is not only organizationally independent, but also has its own legal personality, allowing the parties to spin off any part of their business involved in the joint venture from a commercial and a legal perspective. Additionally, the German legal system provides several legal forms for partnerships *(Personengesellschaften)* rendering nearly any combination of contractual and capital-related elements possible. In general, collaborations based on mere contractual solutions or organized in the legal form of a partnership tend to be more flexible and adaptive during their lifetime. On the other hand, this flexibility comes at the price of lower continuity.

2. Identifying Cooperation Partners in Germany

As already mentioned, the German economy is characterized by a strong group of small to medium-sized highly specialized companies. This is a very promising environment to leverage synergies by merging and combining the expert knowledge found in many of those companies. The German economy is heavily export-oriented. Therefore, many companies operate their business internationally and distribute their products all over the world. As a consequence, there is a wide variety of companies suitable not only for technical collaboration but also for joint ventures focused on sharing distribution networks.

Market participants possibly qualifying for cooperation can be found at the many exhibitions regularly held in the bigger cities. Also, there are several business networks providing assistance and advice regarding the first steps on the German market. Most notably, there is the Chamber of Foreign Trade offering several services and information on the German market as well as on German companies.

The "old" industries like automotive, mechanical engineering, and the production of oil and gas, as well as infrastructure projects, traditionally, and e.g., the offshore wind farm industry, are areas where joint ventures are as useful as common.

3. Typical Legal Considerations for Joint Ventures in Germany (Due Diligence)

a. Legal Provisions for Individual Economic Situations and Cooperation Risks

Assuming that the intended cooperation with a certain company has been evaluated in a first step from a commercial point of view, a subsequent legal review is an essential requirement for a successful implementation of the joint venture. This general rule applies in Germany as well.

Recapitulating the above-mentioned correlation between the shared interests within the cooperation and the parties' very own interests outside of the joint venture, the need for a very sensitive legal analysis becomes apparent. In many cases, the cooperation's limits, whether time-based or factual, are foreseeable from the very beginning or should at least be predicted. Therefore, the parties' expectations for the case of a possible termination of the project in the future should be analyzed and should find legal consideration (developing and integrating an exit scenario).

b. Antitrust and Merger Law

Next to the question of how to legally achieve the parties' commercial interests in the cooperation, there are also legal regulations and requirements in Germany that frequently become relevant during the implementation and operation of a joint venture. In particular, this applies to antitrust and merger control laws. As an example, the simultaneous acquisition of shares in a joint venture company of at least 25% by each of several joint venture parties constitutes a concentration, which may have to be reported to the Federal Cartel Office (FCO) for clearance

if the relevant sales thresholds of the participating entities are exceeded. The Cartel Office will review the cooperation's effect on the relevant markets, namely the markets on which the joint venture will operate. Thereby, the Cartel Office will evaluate whether the cooperation will create or strengthen any dominant position on relevant markets.

Apart from the national merger control laws, national German competition law must also be observed (Act Against Restraints of Competition), which governs agreements between competing companies.

Under EC merger control law, a joint venture performing all the functions of an autonomous economic entity (a "Full Function joint venture") is deemed to be a concentration. Consequently, such cooperation might be restraining competition and therefore be prohibited depending on an evaluation pursuant to Article 101 of the Treaty on the Functioning of the European Union. Thus, the cooperation has to be legally designed in a way that there is – legally – no significant impediment to effective competition between market participants in the EU Member States.

Although the wording of the EC and German regulations on antitrust and merger control is different, the overall assessment carried out under German and EC law is essentially similar. Therefore, the legal situation in Germany will be easily understood by anyone experienced in the European legal standard.

c. Tax Law

In addition to strategic and commercial effects, the definition of the cooperation's terms, and the choice of the legal form, may also affect the tax treatment under German tax law. Although most of the areas of German law provide effective means to find transparent and practicable solutions, German tax law has to be described as complex and challenging. Therefore, professional guidance is required from the very beginning. Primarily, the corporate entities (Limited Liability Companies) enjoy basic protection under double taxation treaties, pro- vided

the chosen structure does not involve improper treaty shopping. Very similar to international tax standards, the transfer pricing of goods and services between participating businesses and the joint venture plays an important role in Germany, too. In general, to qualify for tax purposes, transfer prices have to be at arm's length, which means that unrelated parties would also have agreed upon similar terms.

4. Implementing a Joint Venture in Germany

a. The Consortium Agreement

Notwithstanding the desired legal form, the parties would typically enter into a joint venture agreement or consortium agreement *(Grundlagenvereinbarung)* in a first step, to document the general intent to partner up with each other. The consortium agreement will serve as a kind of foundation of the project and contain a first definition of the shared interests, as well as the aims pursued by the cooperation. Additionally, the parties will outline a closer description of their obligations to further support the project. This comprises agreements regarding the kind and extent of the joint activity, incuding the obligation to create the joint venture itself, provisions governing financial contributions as well as financing obligations, management rules, the supervising regime, dispute resolution mechanisms, protection and transfer of intellectual property rights.

Based on the mutual understanding laid down in the consortium agreement, the necessary legal steps for founding the joint venture will then be taken by the parties.

b. Formation of the Legal Entity

Joint ventures organized in Germany and involving the formation of a German legal business entity will normally be subject to German corporate law. In any event, the by-laws of the business entity and the joint venture agreement have to be carefully coordinated. This applies especially when the parties, for

whatever reason, choose to enter into the joint venture agreement under a law other than German law.

Compared to many foreign jurisdictions, the formal process of forming the legal entity itself is straightforward. In Germany, founding a legal business entity can be achieved within a few days to weeks depending on the chosen legal form. While the simplest legal form of a partnership *(BGB-Gesellschaft)* under German law can even be founded immediately, simply by signing a short agreement, the formation of a corporate entity typically takes a few weeks. There is the possibility, however, to acquire an already founded shelf company and thereby to operate a new corporate entity within a few days.

German corporate law allows the integration of most of the aforementioned strategic aspects as well as the outlined legal requirements and regulations into the joint venture agreement. Additionally, the German legal system is well known for providing effective legal protection and efficient law enforcement. A focus will also have to be put on labor law, IP law and some other areas of German law, which are all governed by the principle of freedom to contract and, thus, allows for operating a joint venture predominantly according to the parties' wishes.

5. Summary

The German jurisdiction is well suited for the implementation and operation of national and multi-national joint ventures. Germany is well known for its transparent and efficient legal system providing effective legal protection at relatively low cost. Additionally, there is a huge market of competitive companies suitable for potential cooperations and joint ventures. Therefore, the jurisdiction as well as the location itself should be seriously considered when planning any market activities within the EU, especially when partnering with a complementary third party by founding a joint venture.

Although the implementation of a joint venture requires careful legal review and guidance, it can be conducted and operated in a speedy and cost-effective manner.

Useful links:

- www.practicallaw.com/2-503-0977?service=crossborder
- www.ahk.de/en/
- www.ec.europa.eu/competition/antitrust/overview_en.html

IV. Corporate Finance

B

In recent years, German companies have discovered innovative corporate finance products. In the past, German corporations were mostly financed by bank debts. As interest on bank debts was relatively low in Germany, banks granted loans freely, and corporations and their shareholders enjoyed tax benefits by financing through bank debts. Due to the restrictions imposed on banks pursuant to the "Basle II" agreement and also because of a change in taxation, many German companies are increasingly interested in equity or mezzanine corporate finance products or corporate bonds.

1. Debt Financing

Senior loans granted by banks are still the most important financing products for German companies. Besides the economic terms of the debt, e.g., interest rate and term of the loan, it is the issue of security that is most important to the bank.

In Germany, all kinds of security are avaiable. There is no general security register in Germany except for real estate. Most of the security may be granted without special formalities. This means the lender would perform a due diligence procedure in order to verify whether and to what extent the borrower has already granted security to a third party. If the borrower has already granted security, the lender would receive security ranked behind prior security. Since the granting of security is not subject to form requirements, however, (not even a written agreement is required), it is not possible to verify without a doubt whether the borrower has already granted security.

Mortgages and land charges have to be registered with the land register in order to become legally effective. The registration form has to be notarized by a notary. There are two different ways to grant security in real estate. The *Hypothe*k, a particular mortgage, is a German specialty. The existence of this mortgage depends on the existence of the loan which it is supposed to secure. When the loan is repaid, the *Hypothek* comes to an end automatically. The second form of security in land is the land charge *(Grundschuld)*. The land charge is generally independent of the loan for which it is granted, unless otherwise provided for in the security agreement. The land registers are kept by the local courts. The land register is not open for free inspection by the public. In order to receive an excerpt from the land register, one must prove a particular interest and justification for reviewing the land register e.g., because one is the owner of the land, or the beneficiary of a security registered on the real property. Unfortunately, land registers work occasionally quite slowly. It may take several weeks to get a registration finalized. There are registration fees, which can be quite high, depending on the value of the security.

B

In order to facilitate refinancings, German banks are free to organize, pursuant to the German Act on the Refinancing Register *(Gesetz zur Neuorganisation der Bundesfinanzverwaltung und zur Schaffung eines Refinanzierungsregisters)*, a Private Refinancing Register *(Refinanzierungsregister)* in which all security is registered. The major benefit of this refinancing register is the possibility to transfer security on real property without registration of ownership of the security in the land register, in particular in connection with true sale securitizations.

Securities through a transfer of assets or receivables for seucrity purposes, pledging of IP rights, pledging of shares in a German *AG*, corporate guarantees, etc. can be granted without any special form requirements. Pledging of shares in a German *GmbH*, however, requires notarization in order to become legally effective.

In Germany, there is no special legislation concerning the granting of security. The German courts, however, have developed a strict regime regarding the granting of security to banks. To protect the suppliers of the party granting a security to a bank, the assignment of receivables for security purposes is legally effective only insofar as the receivables are not already assigned to the supplier under a retention of title agreement or otherwise. The same concept applies to the assignment of inventory. The supplier's retention of title ranks before the bank's security rights. Furthermore, there is a general rule that lenders may not

hold security the value of which materially exceeds the secured loan including interest and costs.

Until a few years ago, the issuance of corporate bonds was usual in Germany only for large-cap companies. This has changed rapidly. In recent years, Germany has developed a successful market for the issuance of corporate bonds at regional stock exchanges also for small and mid-cap companies.

2. Mezzanine Finance

In the past, the granting of mezzanine finance has been used mostly in silent partnership situations in Germany, in particular in order to participate in a business without disclosing the participation. Further, it has been used in venture capital financing rounds, in addition to equity contributions.

A few years ago, German financial institutions have started to offer mezzanine finance products to German companies in addition to their senior loans. Although mezzanine products are at first glance more expensive than senior loans, German companies have become more and more interested in mezzanine products in order to improve their debt/equity ratio – since most of the mezzanine products can be shown as equity in the balance sheet – without divestiture of equity.

Mezzanine products can be structured, in particular, as silent partnerships *(Stille Beteiligung)*, convertible loans/bonds, rights of usufruct *(Genussrechte)*, or subordinated loans.

There are only very few legal regulations for mezzanine finance products in Germany. Mezzanine finance products are usually structured in accordance with the requirements of the individual case.

The chart below shows the major legal implications of the different forms of mezzanine capital products.

	Subordinated Loan	Silent Partnership (typical)	Convertible Bond/Loan	Right of Usufruct (Genussrecht)	Silent Partnership (atypical)
Equity (on the balance sheet)	no	possible	yes, since conversion	possible	possible
Equity (for the rating process)	in general yes	in general yes	yes, if conversion is obligatory	in general yes	yes
Participation in the losses of the company	no	in general yes, can be excluded per agreement	no	in general yes	yes
Liability in case of insolvency	no, but subordinated	no, but subordinated	no, but subordinated	depending on situation	in general yes

3. Equity Participation

Besides debt and mezzanine financing, equity participations began to play an important role for the corporate finance of German businesses. Venture capital and private equity investments have consistently grown in Germany within the last decade. Compared to most other countries, however, equity participations are still rather rare. The same still applies to IPO's. Compared to the number of German companies, market capitalization of German listed companies is rather low. This leads one to believe that the market of equity participations in Germany will rapidly grow in future years.

4. Financing in a Group of Companies

Besides aspects of taxation, there are several complex restrictions pursuant to German corporate law for financing within a group of companies. The most

important rules are the German rules on preserving statutory share capital *(Kapitalerhaltung),* which were revised as of the end of 2008. According to the German rules on preserving statutory share capital, a German corporate entity *(GmbH, AG)* may not make payments to its shareholders which result in any use of the statutory share capital or which may be detrimental to the existence of the company *(existenzvernichtend)*. The repayment of a shareholder loan is explicitly excluded from this general rule, however, unless the repayment could lead to illiquidity of the company. According to German law, even granting an upstream loan from a subsidiary to its parent company may affect the subsidiary's statutory share capital if the repayment of the claim against the parent company is not secure. The same applies to cash-pooling systems when the group of companies is financed by the subsidiary's cash. Further, the granting of security by a subsidiary in order to secure a loan granted to the parent company may be in breach of the rules on preserving statutory share capital.

5. Tax Aspects

As a general rule, interest payments are tax-deductible for income or corporate tax purposes but for trade tax purposes only to a limited extent.

Since 2008, the tax deductibility of interest payments is also restricted by the "interest barrier rule" *(Zinsschranke),* which basically applies to all domestic businesses that generate income from trade and business *(gewerbliche Einkünfte)*. Therefore, this rule may not apply to private equity or venture capital funds which generate income purely from portfolio management *(Vermögensverwaltung)*. Under the interest barrier rule, interest expense in excess of the business's interest income (negative interest balance) is tax deductible only up to 30% of the special tax EBITDA which has to be determined from a tax perspective only. There are three principal exemptions from the interest barrier rule (exemption limit, stand-alone clause and escape clause). The details of this tax regulation are very complex and require thorough review.

Interest for mezzanine products may also be tax-deductible for income tax and corporate tax purposes if the product is adequately structured.

Useful link: · www.bankenverband.de

V. Capital Markets

The legal environment for capital markets is subject to ongoing changes. New EU and German legislation requires issuers and investors to continually monitor their securities compliance. Further, the most important segment for small and mid-sized IPOs, the Entry Standard, was replaced in March 2017 by a new segment called Scale with increased transparency requirements. This is part of an initiative to encourage more IPOs in Germany, in particular in the tech sector. A stable flow of issues like convertible bonds, small and large corporate bonds as well as secondary placements and reverse IPOs can be observed.

"Capital markets" include public offerings, the placement of shares as part of capital increases (in particular, in connection with corporate mergers and take-over offers), block trades of listed shares, and the issuing of convertible and other corporate bonds (high-yield and investment-grade).

The rules contained in codes of conduct, as well as compulsory disclosure requirements for listed companies, including their shareholders and investors, have clearly strengthened over the last years. The European Market Abuse Regulation ("MAR") has further increased not only European standardization but also introduced new compliance obligations. Companies issuing shares must observe these rules now more than ever e.g., in their annual accounts, annual general meetings, and ad-hoc disclosures. In transactions involving listed shares, insider trading and reporting obligations must be taken into account.

Although there are seven regional stock exchanges in Germany, the IPO activity concentrates on the Frankfurt Stock Exchange, which hosts up to 85% of the revenue share within the stock exchanges in Germany (status as of 2016). There are different market segments in which securities can be traded at the Frankfurt Stock Exchange, which have recently been modified: The regulated market, which is divided into the Prime Standard and the General Standard remains the same, whereas the Open Market *(Freiverkehr)* is divided into the Quotation Board and – since March 2017 – the Scale Segment as well as the Basic Board.

All these segments differ with respect to admission requirements, continuing obligations of the issuers, and the involvement of government administration in the trading and price quotation process.

1. *KMU* Segment

In March 2017, the Scale Segment replaced the Entry Standard, which was introduced in 2005. Scale is part of the Open Market designed for small and medium-sized enterprises ("SME" in German: *KMU*). The new segment should support the financial growth of smaller enterprises by enabling easy access to international and national financial investors.

Access to the new *KMU* Segment requires a prospectus or an admission document. Admission requirements include support by a Capital Markets Partner ("CMP") who will verify whether the respective company fulfills all requirements of the new segment or not. Therefore, a legal and financial due diligence is required. A CMP has to be a bank, a law firm or an auditing company. The CMP will also advise on ongoing listing requirements after the start of trading.

Additionally, there are certain special provisions regarding financial figures and business information of the company which have to be met in order to gain access to the Scale Segment. The business must have existed for at least two years, the expected market value of the anticipated shares has to be at least €30 million, the par value has to be €1.00 per share and there must be a minimum free float of 20% or a total of at least 1 million shares. Also, the company must fulfil three out of the following five financial figures: revenue of at least €10 million, equity capital before listing of at least €5 million, at least 20 employees, positive balance sheet equity, and a positive annual net profit.

For the admission of corporate bonds in the Scale Segment, bond-specific financial covenants need to be met.

Companies trading in the Scale Segment will have to publish audited annual financial statements not later than six months after the end of the financial year and unaudited half-yearly financial statements within four months. A mandatory research is organized by Deutsche Börse. In addition, companies have to publish any news or circumstances significant to the valuation of the securities of the company immediately. They are also obliged to maintain insider lists and publish directors' dealings.

The integration in the *KMU* Segment at the Frankfurt Stock Exchange will cost at least €20,000 with additional basic costs of approx. €5,000 per calendar quarter in case of shares and €2,500 in case of bonds, which are higher than such costs in the previous Entry Standard.

2. Basic Board

The Basic Board is the segment for a company which does no longer qualify for the Scale Segment. As a result, the Basic Board is not considered an "entrance", but as a "catch-up" segment.

3. Quotation Board

Already as part of the re-segmentation of the Open Market in 2012, the "First Quotation Board" was closed and united with the "Second Quotation Board" to a then "new" Quotation Board in the Open Market at the Frankfurt Stock Exchange. Unlike the Basic Board and the special *KMU* Segment, the Quotation Board has no transparency requirements.

The Quotation Board comprises initial and secondary listings of bonds and secondary listings of shares. That means that only shares which are already traded at another stock exchange recognized by Deutsche Börse can be listed in the Quotation Board. Thus, for an initial listing of shares in the unregulated market in Frankfurt, the Scale Segment must be chosen.

4. General Standard

The General Standard comprises the basis segment of the regulated market. Admission of securities to this segment is contingent upon the submission and publication of a listing prospectus. In principle, to get admitted to the General Standard, a company must exist for at least three years. The prospectus must comprise annual accounts for three years, those for the two preceding years have to be drawn up under IFRS. Future accounting must follow IFRS as well. Annual and semi-annual reports must be published; ad-hoc disclosures and disclosure of directors' dealings are required. The issuer must disclose deviations from the German Corporate Governance Codex and must comply with stricter provisions concerning its shareholders' meetings.

5. Prime Standard

The Prime Standard is a high-transparency segment for the regulated market. Transparency requirements, in addition to those of the General Standard, comprise quarterly reports, reporting in the English and German languages, and the obligation to hold at least one analyst conference per year.

Currently, IPOs concentrate on the Scale Segment and the Prime Standard. Concepts such as Cold IPOs and Re-IPOs are used already as well.

Useful link: · http://deutsche-boerse.com

VI. Venture Capital Investments

B

Venture capital (VC) investments are a regular and significant part of corporate financing activities of innovative German high-growth companies. Although Germany does not have a long-lasting history of VC investments, the interest of start-ups and the German *"Mittelstand"* in venture capital is continuously growing.

Venture capital investments are typically structured as 100% equity financing. A number of German VC investments, however, are structured as a combination of equity and mezzanine, or debt, financing. Some investors do not even participate directly in the equity of a company, but only grant mezzanine financing, including the right and very often also the obligation, to convert the funds into equity of the company.

Typical VC investments that represent minority stakes in the equity of a company are subject to a legal framework, which is generally similar to the situation in other jurisdictions. There are, however, a few particularities under German law, which must be carefully considered in the negotiation and drafting of VC agreements.

1. Legal Documentation

The legal documentation of a VC round typically consists of the following documents:

- Term Sheet;
- Investment/Stock Purchase Agreement;
- Shareholders' Agreement;
- Articles of Association of the Company;
- By-laws of the Management Board and of the Supervisory Board, if applicable;
- Shareholders' Resolution concerning the capital increase, Subscription
- Deeds, etc.

2. Choosing the Right Legal Form

VC investors usually invest in German corporate entities, as opposed to other legal forms of business, that is to say, either in a stock corporation *(Aktiengesellschaft – AG)* or in a Limited Liability Company *(GmbH)*. The stock corporation has a mandatory dual board system consisting of a Management Board *(Vorstand)* and a Supervisory Board *(Aufsichtsrat)*, whereas the shareholders of the *GmbH* can choose whether the company should have a Supervisory Board or an Advisory Board in addition to the mandatory Management Board and the Shareholders' Meeting. For details, see section on Legal Forms of Doing Business above. As a result of the dual board structure, the shareholders of a stock corporation do not have the power to instruct the Management Board, that is neither on the question whether a given business decision should be carried out nor on how it should be carried out. The shareholders of an *AG* have only limited control over the conduct of business of the company.

The benefit of an *AG*, as compared to the *GmbH*, is particularly the fact that the *AG* can have contingent *(bedingtes)* capital which facilitates the procedures regarding capital increases, in particular for purposes of an employee stock ownership plan (ESOP) or the conversion of convertible loans into equity. Further, the sale of stock held in an *AG* does not require notarization (*GmbH* share sales do require notarization), and an *AG* can issue stock options, which is not possible in case of a *GmbH*.

Currently, however, the majority of investors prefer to invest in a *GmbH*, in particular because there is much more flexibility in adapting the articles of association and the by-laws in a *GmbH* as compared to an *AG*. The corporate governance structure in a *GmbH* can be simple and can provide better control rights for an investor as compared to an *AG*, the investors' rights can be individually adjusted and the capital maintenance restrictions of a *GmbH* are more flexible than in an *AG*. Also, due to a recent change in German corporate law, *AG* and *GmbH* both

can have authorized capital *(genehmigtes Kapital)*, which entitles management to increase the statutory share capital without a separate shareholders' resolution.

3. Special Venture Capital Terms

Most of the typical venture capital provisions can be integrated into the deal provisions of an investment round in Germany, e.g., liquidation preference rights, investor rights, pre-emptive rights, drag-along/take-along provisions, voting rights, etc. Thus, the most important investor rights can be protected in VC agreements under German law. On the other hand, there are still a few particularities that need to be taken into account.

Both the stock corporation and the *GmbH* can issue preferred shares to the VC investor. The conversion of preferred shares, however, into common shares is permissible only at a ratio of one preferred share for one common share. Therefore, anti-dilution provisions may not provide for a change of the conversion ratio. In order to implement an anti-dilution provision, the common shareholders undertake to either transfer shares to the preferred shareholders without additional compensation, or the preferred shareholders are granted rights to purchase new shares issued as part of a capital increase for a low purchase price (minimum one euro per share). Redemption rights are unusual in German VC agreements because, according to German statutory law, the repayment of an equity contribution to a shareholder is permissible under very strict conditions only. Under the German rules on the preservation of statutory share capital (see section on Mergers and Acquisitions above), a company is allowed to reimburse the investor for any losses incurred in the event of a breach of representations and warranties only to the extent that the statutory share capital is not reduced. In order to provide sufficient protection for the investor, it is therefore customary that representations and warranties are granted by the company and in addition by the shareholders. As a compromise between the interest of the investor to receive full protection in the event of a breach of the representations and warranties and the interest of the shareholders and general managers to avoid personal liability, in several cases an adjustment of the valuation of the company is agreed in the event of a breach of representations and warranties instead of a reimbursement of the losses in cash.

In addition, German law is very restrictive regarding the issuance of stock options. Only an *AG* can issue stock options. The basic conditions for the issuance of stock options are subject to mandatory German law. That means it is possible to issue stock options only in the amount of up to 10% of the issued share capital of a company. Due to this fact, virtual share option programs are considered by many companies as an alternative to stock options.

4. Crowdfunding

In the last years, internet platforms were established on which start-ups offer publicly investments in their company by private investors. The crowdfunding platforms offer to invest in the start-up either by way of an equity-based crowdfunding or a credit-based crowdfunding. Currently, the most popular German crowdfunding platforms offer investments as a credit-based crowdfunding by way of issuing subordinated loans. According to the provisions of the subordinated loan agreements, the investors are entitled to a participation in the profits of the start-up and participate in the sales proceeds in an exit event. Only few platforms offer direct participation in the equity of the company.

Currently, the investment in a start-up through crowdfunding is not regulated. The German government is preparing an act for the regulation of, inter alia, crowdfunding, however. The act will most likely contain the provision that the public offer to invest in a start-up through crowdfunding will be subject to the publication of a prospectus provided that (i) the overall offered investment amount will exceed a certain threshold (currently a threshold of €1.0 million is in discussion) or (ii) the maximum investment amount for the individual investor exceeds a certain threshold (currently a threshold of €10,000.00 per investor is

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in discussion). Further, the investors must confirm that they have received formal information about the material conditions of their investment.

Useful links:
- www.bvkap.de
- www.private-equity-forum.de
- www.deutsche-startups.de

VII. Private Equity

1. Introduction / Overview on Private Equity in Germany

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a. Definition of Private Equity in the German Context

Private equity is often defined as the participation of investors in operating companies that are not publicly traded on a stock exchange, concerning also other areas such as venture capital. This broad description of private equity includes all of the most common investment strategies.

In Germany, however, the term private equity restricts itself to what is called private equity in a narrow sense, i.e., the participation of investors as a shareholder of non-listed companies already well established on the market. Details on venture capital investments can be found in the preceding Section which discusses that special field.

b. Development & Economic Importance

Although, in Germany, the first few capital investment companies built up their business in the 1960's, private equity investments, as they are made today, started in the late 1990's and really became popular only shortly after the turn of the millennium. Not only have many investors concentrated their businesses on restructuring Internet startups, but there have also been quite some big investments in industrial companies. With a boom phase beginning in 2003, particularly international investors explored the German market. Subsequently, there have been a number of popular private equity majority investments by international investors in German companies.

Even after the boom phase, however, the private equity sector in Germany has not always been seen positively. In particular, there has been a Locusts Debate *(Heuschreckendebatte)* in Germany in early 2005, when a leading German politician had compared the acting of some investment companies, in particular private equity funds and Hedge funds, with a plague of locusts. The politician especially accused investors of descending on companies and picking them

clean, without caring about employees losing their jobs. Despite this critical discussion, the private equity market in Germany has continued to grow.

In 2008, however, after the Lehman bankruptcy, the industry was considerably weakened for other obvious reasons. Given the fact that private equity investments mainly involve bank financing, there have not been many willing and capable creditors on the market.

After a period of rather weak years, today's private equity market has nearly regained the market position it had before the crisis. This current development and the tremendous importance of private equity on the German capital market are also reflected in some of the figures collected by the *BVK (Bundesverband Deutscher Kapitalbeteiligungsgesellschaften e. V.)* for the year 2016 (see link at the end of the chapter):

In 2016, a total of €5.7 billion was invested in approximately 1,000 companies. Since 2011, private equity investment activity has oscillated on balance at a stable level of between €5.1 billion (2013) and €7.1 billion (2014). German private equity companies were able to raise funds of €2.33 billion.

c. Parties of Private Equity Transactions

- **Investors**

In Germany, different types of private equity investors are active on the market: On the one hand there are German mid-cap investors, which internally can be separated into those which invest in highly profitable companies, and those which invest in companies in a crisis situation. On the other hand, there are the large international investors, which usually perform investments with very high capital volumes. Those large-cap investors have been exploring the German market increasingly for a couple of years. Although there are several reasons for the rising attractiveness of the German market, two main aspects need to be highlighted: On the one hand, the strength of the German economy – especially during the financial crises – has made investments in German enterprises seem

attractive for investors. And on the other hand, many of the family enterprises and owner-managed companies, which make up the major part of German enterprises, have a succession problem, which can be solved by a sale to a private equity investor.

Besides the common private equity investors in the form of private equity funds, a national characteristic of the German private equity market are the family offices. Family offices are not defined consistently, but would typically be referred to as private consulting companies managing capital, investments and trusts for one or more families. The financial capital of a single family office usually is the family's own wealth which normally has been accumulated over a couple of generations, or has been generated through the successful sale of a company. Multi-family offices manage and supervise assets of several families, e.g., on the basis of a management service contract.

Particularly with respect to *Mittelstand* investments some say family offices can provide several advantages compared to other private equity investors: family offices might have a longer investment horizon, a greater network with other family offices and it might even be possible to offer this network to the target company. In case of strategic investments, family offices could probably also provide additional branch-relevant know-how. Furthermore, family offices usually are more flexible than e.g., a private equity fund, since normally such firms will focus on a total return strategy and will not be subject to any strict investment principles.

- **Targets**

Relevant target companies in Germany are most companies operating in the *Mittelstan*d which, in most cases, are sold for reasons of age and/or an acute succession problem.

Further, targets come from the demerger of one or more business units from large corporations, referred to as carve-out transactions.

Finally, several companies are serial targets of private equity investors (so-called "Secondary transactions," see below).

2. Special Forms of PE Investments

Basically, the acquisition of a stake in a company by a private equity investor is accomplished by way of a typical M&A transaction (for more details please see the article in chapter AII). In the following, we will discuss specifics of private equity transactions, which typically lead to a higher complexity level compared to a classical M&A acquisition by a strategic investor.

a. Leveraged Buy Out (LBO)

Leveraged Buy Out (LBO) refers to probably the most common strategy for private equity investments. It is a strategy, as part of a transaction, in which a company, a business unit or business assets are acquired from the current shareholders, typically with the use of financial leverage. A Leveraged Buy Out is financed – at least to a certain extent – with external financing usually provided by banks. In such LBO transactions, it is also common that a private equity investor acquires the target company via a special purpose vehicle (SPV) which finances the transaction with both equity (provided by the private equity investor or the advised private equity fund) and debt.

This structure allows to benefit from the leverage effect. Taking up of bank debt increases the return on equity in case the interest on such bank debt is lower than the return on equity.

Since the investor is financing the investment mostly through banks, the public still sees LBO's as an almost predatory, high-risk transaction model. This scenario is not the standard case, however, as it is sometimes described by the media. Within an LBO transactions, the investor usually uses a combination of several debt instruments, including bank and capital markets dept with an appropriate ratio of equity and debt.

b. Management Buy Out/Management Buy In

Investors in the German private equity market are often concerned whether existing management should keep on acting for the target or if a new management should be implemented. In either case, management typically holds a certain minority interest in the target in order to create incentives, and to avoid the typical principal/agent conflict. This procedure is called Management Buy Out (MBO). If a new management is implemented, it is called Management Buy In (MBI) (for more detailed information on management participations see below).

c. Owner Buy Out/Vendor Loan

Another specific private equity transaction is an Owner Buy Out (OBO). The Owner Buy Out is an acquisition of a company by an investor in which the company owner realizes part of his portfolio while reinvesting in the acquisition company in order to remain a shareholder. This procedure makes it possible that the company owner can still benefit from a positive performance of the company, even after the sale of his company, which can also bridge differences between the seller and the investor regarding the valuation of the company. Furthermore, it helps the investor to finance the transaction; since only a part of the purchase price has to be paid in cash, less equity and/or debt are required to finance it.

Even if the company owner is not interested in such a reinvestment, he can help the investor to finance the transaction by granting a Vendor Loan. Also from the perspective of the seller, such a Vendor Loan is an interesting option, because the seller is typically able to valuate the risk of default of the company realistically.

d. Mezzanine Capital

Another profitable form of combined debt and equity financing used for the expansion of existing companies (after the start-up phase but before going public) is the use of mezzanine capital. A huge advantage of mezzanine capital is that typically there are no inspections of loans and thus the capital is available quickly. The investor providing mezzanine capital will expect a fast return on

the money, however. Furthermore, in case of a mezzanine capital model, the creditor usually will have the right to convert to an ownership or equity interest in the company if the debtor is not able to pay back the full loan in time. Since mezzanine capital is often used by small or mid-sized companies, there might be a greater level of leverage than in the high-yield markets. The typical return on mezzanine capital is said to be between 20% and 30%.

e. Minorities

Generally, private equity investors will strive for majority equity investments or complete takeovers. There have been quite a few minority equity investments in the recent past, however. In such cases, it is of great importance that the minority investor secures an option for an exit, e.g., through contractual agreements with the other shareholders.

3. Management Participation

Management participation is an essential part of many private equity investments in Germany. Although having know-how regarding the acquired business, many private equity investors depend on the commitment of the management running the company. A manager holding a stake in the company is closer to the company and thus more reliable.

private equity investors expect managers to invest own money, however, at better conditions than the private equity investor ("Sweet Equity"). Either the amount per stake to be paid by the manager is lower than the amount to be paid by the investor, or, alternatively, the incentive might be a ratchet, i.e., a preference in favor of the manager if the private equity investment has reached a certain hurdle in the course of the exit.

In general, the participation of the manager is closely linked to his services for the company. Investors want to make sure that the manager is no longer entitled to own a participation in the company once the manager's service agreement

has been terminated. Thus, the manager will be requested to grant an option regarding the sale and transfer of his shares in favor of the investor (or in favor of third parties named by the investor, e.g., successors of the manager), which are triggered by the termination of the service agreement.

The amount of the option price depends on the reason of the termination, where a "Good Leaver Event" such as death, retirement, or permanent disability of the manager leads to a higher price than "Bad Leaver Events." In particular, the termination of the service agreement by the company for cause is typically regarded as Bad Leaver Event.

The same applies in many cases to the termination by the manager. The participation in the company is based on a full commitment of the manager, which no longer exists if the service agreement has ended.

In some cases, however, a termination by the manager after a certain period of time is treated as Good Leaver Event.

The participation of the manager is often subject to "vesting" which means that a manager becomes the unlimited beneficial owner of his stake after a certain period of time has lapsed. Vesting is often structured by way of a scale, where e.g., a third of the participation is vested after one year, two thirds after two years, and the entire participation after three years.

In case of an exit, the shares are generally deemed fully vested ("Accelerated Vesting").

Good Leaver Events, Bad Leaver Events and Vestings have an impact on the compensation to be paid to the manager in case of the exercise of the option.

In case of a Good Leaver Event, the manager usually participates in the market value of his participation, but only to the extent the shares are vested. The calculation of the market value can either be conducted as at the time of the manager leaving the company by detailed calculation principles agreed upon

within the call option agreement (e.g., determination of the enterprise value by multiplying the actual EBITDA with a fixed multiple, this amount then being adjusted by the net debt cash position of the company).

Alternatively, the manager, as a Good Leaver, receives only a certain small portion of his compensation at the time of the end of the service agreement. The latter part would be paid on the basis of the proceeds actually received in the course of the exit by the private equity investor.

Further, the option price amounts to the entire amount the manager has paid for his participation (often plus additional interest).

In case of a Bad Leaver Event, the amount of the participation-related costs are the maximum the manager can receive as compensation in case the call option is excercised.

4. Warranty and Indemmity (W&I) Insurance

In the last few years, W&I insurance has become an integral part of German M&A transactions involving private equity investors (whereas the product is still not known to many corporate M&A parties). This is because vendors of attractive target companies aim not only to achieve a consideration as high as possible but also to lower their risk of liability relating to breaches of representations and warranties granted by them in connection with the sale. Further, private equity vendors will seek for a clean exit in order to avoid internal hold backs of proceeds (reducing the internal rate of return as the proceeds may not be distributed to investors immediately) possibly necessary to compensate claims of the purchaser in case of breaches of reps and warranties. In contrast, the exit buyer will expect a substantial compensation if the reps and warranties turn out to be inaccurate. This clash of interests may be settled by W&I insurances as an instrument that facilitates the deal.

A small double digit number of insurers offer W&I insurance in Germany, some of them now also operating from offices in Germany. As a result, the duration of the underwriting procedure has been shortened significantly in recent years. As the product is still not an established in Germany as for example in the UK, the Nordics or the Netherlands, insurers are keen to conclude underwritings and it is therefore currently not a problem to get M&A transactions insured.

Typically, the underwriting will be made on the buy side, as knowledge of specific risks usually eliminates insurance protection. There are, however, also sell side underwritings, in particular in connection with auction processes with several bidders. In such stapled sell side solutions, the policy will flip to the winning bidder at the time of the execution of the sale agreement.

The policy is in general based on the reps and warranties granted by the seller, however, the insurer will require certain exclusions of liability, in addition to the exclusions under the sale agreement, e.g., IP issues, compliance and transfer pricing issues etc.

Also, the insurers commonly request that due diligence investigations have been performed by external advisors (financial, tax and legal). As a consequence, due diligence findings are generally excluded from the insurance coverage.

Other than in the U.S., European coverage style policies will generally provide for a broad disclosure regime (e.g. generally deeming the data room content as disclosed) but US style coverage is becoming available more commonly which helps to bridge the gap between buyer expectations and seller comfort on US outbound transactions.

Special products are available for certain – also identified/disclosed – risks, in particular in the fields of environmental, tax and litigation cases.

Many insurers are prepared to offer nil recourse solutions where there is no relevant vendor's liability left at all.

5. Holding Phase

After the investor has acquired the target company, the exit-focused investor aims to actually generate added value and to thereby create the conditions for realizing profits by the subsequent sale of the company. The added value can be generated by various means, particularly through different strategic approaches.

Private equity investors often aim to set up a structure where the financing costs of a Newco can be set off tax-wise against profits of the target company, subject to certain conditions. This can be achieved by a merger of the two entities or by conclusion of a profit transfer agreement.

A widely recognized strategic model is what is referred to as the Buy and Build strategy. The investor typically acquires first a company from a particular branch as a nucleus, with a view to directly build a larger group of companies by adding further acquisitions from the same sector. Using such strategies, the investor can realize synergetic effects, because the built-up corporate group can subsequently be sold with higher valuation parameters.

Another strategy is to perform a split-up. A split-up has the objective to split up the target company, since the value of the company might be higher if it is separated into different parts. Often, investment tactics used within a split-up might be quite aggressive, and such a model usually involves enormous layoffs as part of the restructuring process.

Other investors, particularly including those who specialize in distressed investments, focus on the refinancing of companies. The goal here is to generate added value by improving the company's balance sheet, particularly on the liabilities side.

In the event – as it is usually the case – the company has been acquired by way of a leveraged buy out, the holding phase particularly is used for the repayment of the acquisition financing. For this purpose, the liabilities of acquisition financing will partly be transferred directly to the level of the acquired company, by merger or any other measures (Debt Push Down). Alternatively, the distribution of profits of the acquired company to the acquisition vehicle can also be used for the amortization of the acquisition financing.

From an operational perspective, the holding phase is characterized by the fact that the investor will usually not interfere with the daily business of the acquired company. Normally, the investor only takes up monitoring and consulting functions by placing its representatives in the supervisory board or the advisory board, avoiding, however, that such representatives have the majority in the board. The reason for this strategy is that for tax reasons the status of an asset manager for private equity investors is of special importance. In order not to lose that status, it is necessary that the investor does not interfere with the management of the company on the operational level.

6. Exit

Typically, private equity investments are exit-focused. Particularly in the German markets, however, this does not apply to all investment models.

An attractive solution for an exit of a private equity investor is commonly seen in an initial public offering (IPO) of the acquired company. The background to this is that U.S. empirical studies have shown that the increase in value by an exit through an IPO is higher than by any other exit strategy. In Germany, however, exits through an IPO are still rarely a possiblility. Only a few private equity investors have actually performed an IPO so far, and those transactions have been of high volume. In Germany, the exit by a trade sale, i.e., the sale of the acquired company to a strategic investor, is much more common. By a clear margin, trade sales are the most common exit strategy in Germany. Potential buyers typically are direct competitors of the portfolio company as well as companies on other levels of the value-added chain, i.e., typically customers or suppliers of the respective company. Trade sales are usually realized by a bidding process. Here it is naturally the goal of any private equity investor to gain a strategic bonus in addition to the mere nominal value of the company.

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Besides the sale to strategic investors, the sale to other private equity investors ("Secondaries") have become more and more popular in Germany in recent years. In case of a Secondary, the investor usually will not generate a strategic bonus that is as high as in the case of a trade sale to a strategic investor. Due to the currently high liquidity on the private equity market, however, higher purchase prices can be achieved than a few years ago. Therefore, private equity investors, which have acquired an equity participation some time ago, might today be able to generate profits from the sale without any strategic bonus just because of higher valuation parameters. There are actually a couple of target companies that have been subject to two and more private equity transactions.

7. Summary and Outlook on Private Equity in Germany

According to the BVK e.V. (see link at the end of the chapter) in 2016 German private equity investors held 7,100 participations and the portfolio amounted to €39.6 billion. The trend is upwards. Since private equity investments can be a big chance for companies of any size and since Germany is driven by its strong *Mittelstand*, nowadays many private equity funds are investing in companies of the *Mittelstand* on a long-term basis. Given the fact that the *Mittelstand* is the backbone of the German economy, private equity investments will be very important for all future economic developments over here and in the entire world. Further, as a consequence of expected multi-national mergers a strong deal flow is presumed to come from post merger carve-out situations.

Useful link: · http://www.bvkap.de/en/market/statistics

VIII. Investment Funds

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Before July 2013, the rules governing and regulating investment funds in Germany were spread across several different German laws. With the European Directive on Alternative investment fund Managers (Directive 2011/61/EU, "AIFM Directive"), requiring Germany to transpose respective EU rules into German national laws, Germany has consolidated the rules on investment funds in the German Capital Investment Code *(Kapitalanlagegesetzbuch, "KAGB")*. The AIFM Directive and its transposition in the *KAGB* have extended the scope of regulation from open-ended funds to closed-end funds. Thereby, the private placements regime, i.e., the possibility for unregulated marketing and distribution of alternative investment funds, was abolished in Germany. The *KAGB*, which comprises 358 sections, came into effect on July 22, 2013. Since then, the *KAGB* has been slightly modified twice.

Even if a fund is not regulated by the *KAGB*, other regulations might be applicable [e.g., Capital Investment Act *(Vermögensanlagengese*tz)]. Therefore, most of the investment products may not be offered for public sale without a prospectus.

In the following, the regulatory framework of the *KAGB* will be described.

1. Definition of Investment Funds

According to the *KAGB*, a fund is defined as a collective investment undertaking, which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of the investors and which is not an operating company outside the financial sector ("investment fund").

As this substance-based definition is rather broad and phrased in a vague language, the market was – and still is – faced with a certain degree of uncertainty and the need to carefully review on a case-by-case basis as to whether or not any special regulation according to the *KAGB* has to be adhered to. In consequence, for instance, joint venture structures, acquisition structures for private equity transactions, investments of family offices or structures for project

developments have to be reviewed to determine as to whether or not German regulations have to be considered.

In addition to this broad definition, several exemptions apply for the application of the *KAGB*. For instance, the *KAGB* is not applicable to investment funds not open for more than one investor, holding companies, institutions managing funds for old-age benefits and pensions, employee participation or employee savings schemes, and securitizations special purpose vehicles.

The breach of applicable rules of the *KAGB* may result in orders by the regulating body to cure such breach, the levying of fines and potential criminal presecution.

2. Types of Investment Funds

The *KAGB* distinguishes between Collective Investment in Transferable Securities ("UCITS") and Alternative investment funds ("AIF"). UCITS invest in transferable securities and are heavily regulated according to the European Directive on UCITS (Directive 2009/65/EG). AIFs are investment funds, which do not qualify as UCITS. AIFs mostly invest in real assets (for example real estate and wind farms), private equity structures or other funds.

The law further distinguishes between open-ended and closed-end investment funds. Open-ended investment funds are

- UCITS and
- AIFs that allow investors to return their participation prior to the commencement of their liquidation phase or wind-down.

In cases of closed-end investment funds the investors may not return their participation during the term of the AIF.

Furthermore, AIF can be structured as "Retail AIFs" or "Special AIFs." These different types of AIFs are differentiated based on the permissible investors (regarding the types of investors see following section 3). Special-AIFs are open

for semi-professional and professional investors. Retail AIFs may be marketed to all types of investors. Therefore, Retail-AIFs are subject to the most detailed regulation (which includes, for instance, permissible leverage).

3. Types of Investors

According to the aforementioned, the *KAGB* distinguishes between professional, semi-professional and retail investors.

Professional investors are those listed in Annex II of Directive 2004/39/ EC ("MIFID") which include, for instance, credit institutions, investment firms, other authorized or regulated financial institutions, insurance companies, pension funds, and large undertakings meeting at least two of the following size requirements on a company basis: Balance sheet total €20 million, net revenue €40 million or own funds €2 million.

While introducing a new category of investors, the semi-professional investors, Germany goes beyond the requirements of the AIFM Directive. Semi-professional investors are defined by a minimum investment amount of €200,000 and a certain degree of sophistication. Semi-professional investors are treated the same as professional investors. Such investors are entitled to waive some of the protection provided by the *KAGB*. This requires the investment firm to adequately assess the expertise, experience and knowledge of the prospective semi-professional investor in light of the nature of that investment. The investor has to be capable of making his own investment decisions and has to understand the risks involved.

Finally, the *KAGB* defines retail investors as those that fall outside the definition of professional and semi-professional investors.

4. Alternative Investment Fund Manager

Each investment fund needs to be managed by a Manager of Alternative investment funds ("AIFM"). Before acting as AIFM, the respective company has to be authorized by the regulatory authority *(Bundesanstalt für Finanzdienstleistungsaufsicht, "BaFin")*.

AIFMs which manage Special AIFs with assets under management (i) when debt financed is not exceeding a threshold of €100 million or otherwise (ii) not exceeding a threshold of €500 million, (small or registered AIFMs), are subject to a reduced set of regulatory rules. Please note that such small AIFMs have the opportunity to opt-in to the regular AIFM regime which may provide benefits, such as the EU passport.

The authorization requires meeting, inter alia, the following prerequisites:

- Minimum nominal capital for AIFMs from €125k to €300k (depending on the business area of the AIFM);
- Additional nominal capital based upon certain asset under management thresholds;
- Further capital or insurance cover is required to cover potential professional liability resulting from activities as an AIFM;
- Reliability and professional suitability of the management (expertise and experience) of the AIFM with regard to the managed investments;
- Business plan describing the contemplated business transactions as well as the organization, including risk management and portfolio management;
- Information regarding any substantial owners including information regarding their reliability and ownership percentage;
- Details regarding the remuneration procedure and practices;
- Details regarding delegation of functions.

5. Delegation by the AIFM

The AIFM may delegate some of its functions to third parties under so-called delegation agreements. Such delegation is subject to several conditions, however, which include:

- The AIFM has to have objective reasons for the delegation;
- The delegate has to have sufficient resources for the execution of the delegated functions and the personnel managing the delegate has to be experienced and of good repute;
- The AIFM has to have effective supervision of the delegate, including contractual termination and instruction rights vis-à-vis the delegate;
- The AIFM has to continually monitor the services provided by the delegate;
- For the delegation of risk management or portfolio management, additional conditions have to be met, especially in case the delegate is not an EU resident, effective collaboration of the BaFin and the other competent regulatory body has to be ensured;
- Delegation is neither to impair supervision of the AIFM nor to result in a conflict of interest to the detriment of the investors.

These requirements do not apply to the procurement of ancillary services like caretaker services.

6. Depository

The AIFM has to appoint a single depository for each AIF managed. The role of the depository is to monitor the receipt of all investors' subscriptions, ensure proper monitoring of AIF's cash flows, safekeeping of the assets and includes oversight functions.

The depository has to be a credit institution with its registered seat within the EU, an investment firm with its registered seat within the EU or any other entity which is subject to continued supervision and regulation and falls within certain

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categories of institutions identified by the EU Member States to be eligible under Sec 80 para. 2 no. 3 *KAGB*. In case of certain German closed-end AIFs, the depositary may be an entity which carries out depositary functions as part of its professional or business activities in respect of which such entity is subject to mandatory professional registration (i.e., auditing firm).

7. Marketing/Documentation

The prerequisites for the marketing of investment funds in Germany differ between UCITS and AIFs, also depending on the type of investors addressed. In all cases, the BaFin has to be notified of marketing activities. Specific documentation, information and publication obligations have to be met. In addition, rules for the advertisement, the used language, and details of costs for the investors have to be followed. Furthermore, the *KAGB* provides for a liability regime concerning information contained in marketing documents.

8. Valuation

The assets of a UCITS or an AIF have to be valued by an independent valuer at least once a year. In some cases, the assets have to be valued before their acquisition by the investment fund.

9. Taxation

For German tax purposes, investment funds in the sense of the *KAGB* generally fall in three different categories (i) (non-partnership) mutual investment funds, (ii) (non-partnership) special investment funds, and (iii) partnerships.

a. (Non-Partnership) Mutual Investment Funds

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Mutual investment funds, special investment funds as well as single-investor investment funds, asset managing corporations and group AIFs are subject to the German Investment Tax Act *(Investmentsteuergesetz 2018*), a special tax regime.

German and non-German mutual investment funds are subject to corporate income tax *(Körperschaftsteuer)* with regard to their German source income and are exempt from trade tax *(Gewerbesteuer)*. Tax exemptions apply to the extent tax exempt investors are invested in such mutual investment funds.

The investor is generally subject to tax once he receives dividends from the mutual investment fund or disposes of his investment. In addition, the investor might be subject to tax on deemed distributions for advance lump sum amounts. Depending on the type of mutual investment fund (the law distinguishes between equity or stock funds, mixed funds, domestic real estate funds and foreign real estate funds), the income resulting from the investment is subject to partial exemptions ranging from 15% to 80%. Such exemptions intend to compensate for (partial) taxation of the income at the level of the mutual investment fund.

b. (Non-Partnership) Special Investment Funds

For the German Investment Tax Act to apply, a special investment fund has to meet certain requirements, for instance, (i) its actual purpose has to be limited to the investment and management of funds for the benefit of the investors, (ii) may not actively engage in the management of the assets, (iii) it has to meet certain investment limitations and (iv) the investors need to have the right to return on their investment at least once a year. In addition, not more than one hundred investors are to be directly or indirectly (through partnerships) invested in the special investment fund. Furthermore, individuals may only invest in special investment funds if the participation is attributable to their business assets and in other limited scenarios. Special investment funds are generally subject to tax similar to mutual investment funds, however, special investment funds may opt

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into a transparent tax regime. In such case, the investors are treated as if they had received the respective income directly.

c. Partnerships and Other Exemptions From the Investment Tax Act

AIFs in the legal form of a (foreign or domestic) partnership (with the exception of UCITS in the sense of Section 1 para. 2 KAGB and pension plan asset funds), REITs and investment companies in the sense of Section 1a para. 1 of the Law on private equity Investment Companies *(Gesetz über Unternehmensbeteiligungsgesellschaften)* are not subject to the German Investment Tax Act. In consequence, AIFs in the legal form of a partnership are generally subject to the ordinary regime on partnership taxation (for more details see section regarding German taxation).

Useful links:

- https://www.bafin.de/EN/PublikationenDaten/Datenbanken/Investmentfonds/investmentfonds_artikel_en.html
- https://www.bafin.de/EN/Aufsicht/KVGenInvestmentfonds/ErlaubnisVertrieb/Deutschland/sitz_deutschland_node_en.html
- https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Fachartikel/2015/fa_bj_1507_kapitalverwaltungsgesellschaften_en.html

IX. Public Private Partnerships and Project Finance

1. Public Private Partnerships (PPPs)

a. Introduction to PPPs

Public Private Partnerships (PPPs) aim at increasing the efficiency of infrastructure projects by means of a long-term collaboration between the public sector and private businesses. Here, a holistic approach is important that extends over the entire life cycle of a PPP project (planning, construction, financing, operating and, where required, liquidation). In a Public Private Partnership, the public sector regularly maintains an oversight and quality assessment role, while the private sector is more closely involved in the delivery of the service or physical creation of the project facilities. The private financiers take on construction and operating risks, while host governments cover market risks.

PPP projects have been widespread in Germany, particularly at the federal level. According to the statistics of the public overall debt, issued by the German Federal Statistical Office for the year 2016, the total project amount (i.e. investment, operation and other costs) owed by the public sector to its private partners in PPP projects is €30.69 billion, with €5.59 billion payments already made.

As of August 2017, the PPP database of the German Federal Ministry of Finance lists 198 projects with concluded contracts, plus 35 contracts with PPP elements, and 27 projects in the tender process, including several projects for highway construction. Between 2003 and 2015, about €6.73 billion have been invested in building construction, and about €3.5 billion in traffic infrastructure in PPP projects, according to the Federation of the German Construction Industry.

PPPs are already established in the areas expected to play a key role in the future, such as schools, sports, tourism, leisure and administrative offices (for municipalities) and transportation, administrative buildings, and the judiciary (at federal and state levels). Important sectors also include culture, childcare, urban development, the environment and supply services (municipalities) and health, public safety, and e-government.

Increasingly, PPPs are becoming fixed items on the agendas of large cities, over half of which opt for this strategy to realize projects. Although PPPs have not yet become broadly established, they will surely play a greater role in the future in fulfilling public service tasks.

b. Benefits of PPPs

Governments tender PPPs to take advantage of private sector expertise, their ability to manage risks, and be innovative. In many cases, the private sector can bring its own financing to the table (see section on Project Finance for PPPs below). By introducing private partners, which put their own skills and capital into the project, the public sector obtains the benefits of commercial efficiencies and innovations as well as timely delivery.

One expert report, initiated by the PPP Steering Committee in public engineering, under the leadership of the Federal Ministry for Transport, Building and Urban Development, investigated, among other things, 46 projects, 20 of which have been completed. The figures for construction costs in tender quotations were, on average, approximately 20 % lower than the planning figures. In 19 of the 20 projects that had finalized their accounts, the final accounting figures were at the same level as the figures quoted in tenders. As far as construction times were concerned, there were savings, sometimes even quite considerable ones.

c. Impact of Legal Framework

Implementing PPP projects means observing many restrictions from different fields of law, especially budget law, public procurement law, grants and subsidies restrictions and tax laws. PPP projects do not aim at bypassing the laws that regulate procurement and the awarding of contracts. There must be public calls for tenders for PPP contracts above certain threshold values. The regulations of the law governing the awarding of contracts also dictate whether the PPP contract partner must make public calls for tenders when subcontracting subsequently.

To accelerate and simplify the implementation of PPP projects, the Act Concerning the Acceleration of Public Private Partnership Projects and the Improvement of the Legal Framework for Public Private Partnerships *(Gesetz zur Beschleunigung der Umsetzung von Öffentlich Privaten Partnerschaften und zur Verbesserung gesetzlicher Rahmenbedingungen für Öffentlich Private Partnerschaften – short: ÖPP-Beschleunigungsgesetz)* eliminates restraints in several fields. The *ÖPP-Beschleunigungsgesetz* modified provisions of public procurement law, tax law and budget law. During the phase of public procurement, the public partner can now negotiate with the private partner about details of the partnership. For the promotion of PPPs, budget law now provides that the economic feasibility comparison also has to consider the distribution of risks connected with the measure.

2. Project Finance for PPPs

For decades, project finance has been a popular form of financing for large-scale infrastructure projects worldwide and is especially suitable for financing PPPs.

Project finance can be defined as the long-term financing of infrastructure, industrial projects and public services based upon a non-recourse or limited recourse financial structure, where project debt and equity used to finance the project are paid back from the cash flow generated by the project. In other words, project finance is a loan structure that relies primarily on the cash flow of the project for repayment, with its assets, rights, and interests held as secondary security or collateral. Project finance aims to strike a balance between the need for sharing the risk of sizeable investments among multiple investors and, at the same time, the importance of effectively monitoring managerial actions and ensuring a coordinated effort by all project-related parties.

Project finance lending is not dependent upon the current assets of the project company, but on the expected cash flow. Project finance is especially attractive to the private sector, because major projects can be funded off balance sheet.

B

This means that the participation in the project can be disclosed as an investment, and the debt can be excluded from the financial statements.

The attractiveness of financing a PPP project, though, lies in the high credit rating of the participating government and the view to the expected cash flow. The public partner is the one, which generates the cash flow and usually cannot go bankrupt, so the investor has a high security regarding expected revenues. To the extent that project finance is appropriate, sponsors may not need to pledge their own general credit beyond required completion undertakings. The importance of the expected cash flow allows companies to manage finance of the PPP, which could not receive corporate credit rating based financing.

X. Banking and Financial Services

1. Regulatory Issues under the European Banking Union in Germany

a. Historical Background

Some parts of Germany's banking business have been regulated for more than a century. A general regulatory regime, however, was first created in 1934. Major modifications occurred after the end of World War II and led to the Banking Act *(Gesetz über das Kreditwesen, Kreditwesengesetz – KWG)* of 1961. Under the *KWG*, anyone dealing with funds up to a certain value in defined banking activities became subject to a licensing requirement. Such core activities including e.g., the deposit business (acceptance of funds as deposits), the granting of monetary loans and acceptance credits (lending business), the purchase of bills of exchange and checks (discount business).

The national supervisory authority in Germany is the Federal Financial Supervisory Authority *(Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin)* which not only supervises banks, financial services institutions, and insurance companies, but is also in charge of capital markets supervision. *BaFin* is a steadily growing body which is located partly in Bonn, partly in Frankfurt. As far as banking is concerned, the Federal Reserve Bank *(Bundesbank)* is still involved in day-to-day supervision, but after the creation of *BaFin,* the relative importance of the *Bundesbank* has been reduced considerably. In the meantime, *BaFin* shares its competence with the newly formed supervisory body of the European Central Bank (ECB). In respect of Germany's most important credit institutions, *BaFin* is going to lose the bulk of its current competences. Its competence is limited to smaller credit institutions and other financial services providers.

Much of banking supervision in Germany is based on a reporting system pursuant to which the banks have to file periodic reports or notifications. Over the last few years, *BaFin* has increasingly commissioned special inspections (mostly conducted by certified public auditors) for specific problem areas in individual banks.

In 2011, the European System of Financial Supervision (ESFS) was born. It consists of the European Systemic Risk Board (ESRB) and three European Supervisory Authorities (ESAs): the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA). In November 2014, the starting signal for the three-pillared European Banking Union was given with the establishment of the Single Supervisory Mechanism (SSM), consisting of the European Central Bank and all national supervisory authorities. As a consequence and as mentioned before, it is the European Central Bank that will be competent for directly supervising Germany's biggest credit institutions. Since January 2016, the Single Resolution Mechanism (SRM) as central institution for bank resolution has been added to the European Banking Union. In November 2015, the Commission planned to complete the European Banking Union with a proposal to set up a European deposit insurance scheme (EDIS) for bank deposits in the euro area.

b. Banking under CRR and CRD IV

The statutory requirements for obtaining a banking license or a license as a financial institution are already essentially similar (though not quite identical) throughout the European Union. These conditions regulate the required own funds, quality of management, organization of the business, and observation of other regulatory requirements. This process of harmonization has been intensified by the enactment of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD IV). Much of the CRR and CRD IV is derived from the *Basel III* standards issued by the *Basel* Committee on Banking Supervision (BCBS). In September 2010, the *Basel* Committee on Banking Supervision had developed a comprehensive set of reform measures to strengthen the regulation, supervision, and risk management of the banking sector: "*Basel III*." *Basel III* will modify the *Basel II* framework by implementing a global liquidity standard and by raising the core capital ratio.

CRR and CRD IV included most of the technical provisions of *Basel III* governing the prudential supervision of institutions. Whereas CRR is directly applicable, CRD IV has been implemented in Germany mostly by an extension of the *KWG*, which constitutes the core German supervisory law. Both CRR and the new rules by means of which CRD IV has been implemented came into effect on January 1, 2014. Though, several periods of transition will mitigate consequences for institutes. For instance, CRR requirements on core capital will not fully take effect before January 1, 2019.

c. Further Important Laws Regarding Banking and Financial Services

Further laws, regulations and rules in this context in Germany are:

- *SolvV (Solvabilitätsverordnung)* – Regulation governing operating procedures with regard to CRR;
- *GroMiKV (Großkredit- und Millionenkreditverordnung)* – Regulation governing large exposures and loans;
- *MaRisk (Mindestanforderungen an das Risikomanagement)* – Minimum Requirements for Risk Management.

A major regulatory shift concerning the prescribed organization of institutes is the Separation of Banking Functions Act *(Trennbankengesetz)*. In the past, German banks normally used to be "universal banks," meaning that each bank was allowed to engage in any kind of banking business; there was no regulatory distinction between an investment bank, merchant bank, etc. Now, banks of a distinctive size are required to separate their savings and loans business from the parts of the institute engaged in proprietary transactions.

d. Three-Pillared German Banking System

With regard to the legal nature of banks, there are three types of banks in Germany: private banks *(Privatbanken)*, savings and loan banks *(Sparkassen)* and mutuals *(Genossenschaften)*.

The private banks *(Privatbanken)* are mostly operated as stock corporations *(AG)* or Limited Liability Companies *(GmbH)*. Most of them act nationwide.

The savings and loan banks *(Sparkassen)* are essentially created under the laws of the individual German States *(Länder)* and are mostly linked to communal shareholders (their position is similar to that of shareholders, but the legal construction is different). In the past, such communal bodies, which under German law cannot be declared insolvent, generally guaranteed any debt of the *Sparkasse*. As a consequence of the transposition of EC law, this protection no longer exists. The former status of the State Banks *(Landesbanken)* as public law State Banks guaranteed by the States has been changed upon implementation of pertinent EC law, and the *Landesbanken* now are organized as stock corporations, their shares being held by one or several States and / or savings and loans banks / savings and loans bank associations.

The third type of banks are the mutuals *(Genossenschaften)*, which initially were mostly local organizations of private individuals who had contributed some capital.

While the private banks have traditionally been the largest banks, savings and loans as well as mutuals have gone through a series of mergers, which resulted in a substantial increase of the average size. The savings and loan banks as well as the mutuals have normally only one bank in a specific area, and on a local/regional scale, they compete against the private banks quite effectively.

The savings and loans as a financial group overall comprise about 29.7% of the German market, the private banks approximately 35.4% the mutuals approximately 15.6% and other credit institutes approximately 19.3%.

2. Financial Services

All institutions dealing with financial instruments are required to obtain a license of *BaFin*. Furthermore, several reporting and business conduct rules apply. Competence of BaFin in this field has largely been untouched by the recent shift of competences to ECB.

On October 31, 2009, the Payment Services Directive 2007/64/EC (PSD) was transposed into German law. The PSD regulates payment services and payment service providers throughout the European Union (EU) and the European Economic Area (EEA). The purpose is to increase pan-European competition and participation in the payments industry (also from non-banks), as well as to provide for a level playing field by harmonizing consumer protection and the rights/obligations for payment providers and users. Whereas SEPA (Single Euro Payments Area) is a self-regulatory initiative by the banking sector of Europe, which defines the harmonization of payment products, infrastructures, and technical standards, the PSD is driven by regulators and provides for the necessary legal framework within which all payment service providers will operate. The PSD contains two main sections: the market rules for payment service providers and the business conduct rules.

The Second Payment Services Directive, which will be transposed into national law by January 2018, regulates payment initiation services and account information services. Requirements of the technical security of electronic payment systems will be tighter.

Since July 22, 2013, the statutory basis for managing both open-ended and closed-end funds is the new German Capital Investment Code *(Kapitalanlagegesetzbuch, KAGB)*. The German Capital Investment Code, which transposes the European Union's Alternative Investment Fund Managers (AIFM) Directive, has replaced the German Investment Act *(Investmentgesetz)*. Its aim is to create a uniform standard of investor protection and curb the grey capital market. The Code will apply to all those who manage either open-ended or closed-end funds. As such, closed-end fund managers will for the first time be obliged to comply with the type of legislation that has long governed open-ended funds. The Capital Investment Code distinguishes between fund types defined as either Undertakings for Collective Investment in Transferable Securities (UCITS) or as Alternative investment funds (AIFs). The AIF category will include all closed-ended funds and those open-ended investment funds regulated under investment legislation

but not defined as UCITS. These are mainly open-ended special institutional funds *(Spezialfonds)* and open-ended property funds. Different licensing and reporting requirements will be in place for UCITS and AIF managers. By March 2016, UCITS-V-Directive has been implemented in Germany. Thereby, UCITS management company's remuneration system was aligned to the principles for AIF management companies. Moreover, the scope of fines was extended.

The MIFID (Markets in Financial Instruments Directive of the EU) transposition into German law took effect as of November 1, 2007 and replaced the Investment Services Directive. The main objectives of the Directive are to increase competition and consumer protection in investment services. MiFID retained the principles of the EU passport introduced by the Investment Services Directive (ISD) but introduced the concept of maximum harmonization which places more emphasis on Home State supervision. This is a change from the prior EU financial service legislation, which featured a minimum harmonization and mutual recognition concept. Maximum harmonization does not permit States to be superequivalent or to gold-plate EU requirements detrimental to a level playing field. In October 2011, the European Commission adopted a revision of MIFID by MIFID II. It consists of a Directive and a Regulation. Its aim is to make financial markets more efficient, resilient and transparent, and to strengthen the protection of investors. The new framework will also increase the supervisory powers of regulators and provide clear operating rules for all trading activities. The MiFID II Directive and the Markets in Financial Instruments Regulation (MiFIR) were adopted by the Council of the EU on May 13, 2014 and by the European Parliament on April 15, 2014. Both the MiFID II Directive and MiFIR will be applicable within Member States on January 3, 2018.

Useful links:
- www.bafin.de
- www.bundesbank.de
- www.vab.de

XI. Insolvency, Reorganization, Restructuring

Since the last edition of this booklet, the legislator undertook major modifications in the German Insolvency Code to strengthen the influence of the debtor and the creditors, the right of self-administration, and the insolvency plan proceedings.

1. Statutory Background

As of January 1, 1999, the revised German Insolvency Code *(Insolvenzordnung – InsO)* has governed bankruptcies and reorganizations in Germany. The Insolvency Code revised German insolvency law materially. The need for a reform became obvious many years ago when Germany's former bankruptcy laws proved inadequate to deal with a dramatically increasing number of business insolvencies. Before the present law went into effect, 75% of all petitions for insolvency were dismissed by the courts for insufficiency of assets. In less than 1% of all cases, a debtor's reorganization was achieved successfully. In order to further adapt German insolvency law to the demand for a law supporting restructuring in a better way, the German Insolvency Code underwent another substantial amendment in March 2012. Taking effect as of March 1, 2012, the German legislature heralded a paradigm change by (1) strengthening debtors' and creditors' influence on the insolvency court's selection of the administrator/trustee, (2) refining the option of self-administration *(Eigenverwaltung),* and (3) revising the insolvency plan proceedings. Currently, there is a further government bill, resolved by the German federal cabinet, which envisages, inter alia, amendments to the InsO, the Commercial Code (HGB) and the Banking Act (KWG). The aim of the bill is to provide debtors with the possibility of joining several single insolvency proceedings into one proceeding if estates of affiliated debtors are involved. The bill ties in with already applicable law and practices and attempts to create new statutory sources or to improve already existing deficient ones. The core issue of the bill is to arrange for a better-coordinated handling of proceedings in the context of an affiliated group of debtors. New regulations concerning legal venue and competence of insolvency judges in

view of multiple affiliated group members with different domiciles and the co-operation of multiple insolvency administrators are part of the bill. The bill also attempts to integrate a new coordination process *(Koordinationsverfahren)* into the existing insolvency law. The bill, however, will not result in an amalgamation or other merging of the group companies' assets. The principle set out by German insolvency law – one corporate debtor, one proceeding – will remain unaffected.

2. Starting Insolvency Proceedings

a. Admissibility

In principle, insolvency proceedings can be initiated against any natural or legal person. Only public legal bodies are excluded.

b. Reasons for Applying for Insolvency Proceedings

Insolvency proceedings require that a debtor be in one of the following three situations: it is illiquid, it is over-indebted, or it is exposed to impending illiquidity.

The last-mentioned reason for applying for insolvency proceedings is only admissible if the insolvency proceedings are initiated by the debtor. The concept of impending illiquidity gives the debtor the possibility to initiate insolvency proceedings when it becomes clear that it is unable to meet its debts as they fall due.

Insolvency proceedings start with the filing of a petition by a creditor or by the debtor. The applicant must show credibly that at least one of the three above-named legal conditions is fulfilled.

The difficulty is to evaluate if the debtor is illiquid, over-indebted, or exposed to impending illiquidity. A debtor is illiquid if it is unable to pay at least 90% of its due obligations from its liquid capital and its reserves payable within the next three weeks. Pursuant to the current legal definition, a debtor is over-indebted when its assets no longer cover its liabilities, unless there is a predominant probability that the business can financially recover and continue. Such probability is

determined by way of a continuation forecast *(Fortführungsprognose)*, which determines whether the financial strength of the company is sufficient to ensure its economic survival. The forecast must be prepared at least for both the current and the subsequent financial year, verifying that the debtor company will be able to keep itself liquid to an acceptable degree. If continuation is not predominantly probable (e.g., illiquidity is imminent within the current or the following financial year, or other circumstances will prevent continuation of the business), the over-indebtedness must be determined by way of a pre-insolvency balance sheet test *(Überschuldungsstatus)*. Pre-insolvency balance sheet assets must be valued at their liquidation values, that is, at their present market value under the assumption of a liquidation sale, thus including possible hidden reserves not shown in the commercial balance sheet and taking into account the regularly very substantial discounts on book values which are realized under liquidation sale conditions.

c. Obligation to Initiate Proceedings

Registered general managers of a German limited liability company, as well as the members of the management board of a stock company, have the statutory duty to file, without undue delay, a petition for commencement of insolvency proceedings, in no event later than three weeks from the date on which any of the above-mentioned bankruptcy causes (except impending illiquidity) have been discovered. Similar duties exist for the general managers of other forms of business organizations. There is a duty to regularly review the financial situation for this purpose. Apart from criminal sanctions, a failure to meet this obligation may result in the personal liability of the parties responsible for the omission and any damage caused by that default. If a person is not a registered general manager or a member of the management board but behaves like one, he or she may be obligated in the same way. Shareholders of a company and members of the supervisory board are not obligated to file a petition unless the company is without management and the members or the supervisory board know of the company's pending insolvency.

d. Measures of the Bankruptcy Court

The petition has to be filed with the bankruptcy court, a department of the competent Local Court *(Amtsgericht)*. This will normally be the court at the place where the debtor's center of main interests or the registered office is located.

As a first measure, the court may appoint an expert to verify whether the debtor is in one of the three above-mentioned situations. Furthermore, the bankruptcy court may appoint a preliminary insolvency administrator to secure the assets and to clarify whether all insolvency preconditions are properly met. As ultima ratio, the bankruptcy court may order at this early stage that the administrative power and the power of disposition over the debtor's assets will be transferred to the preliminary insolvency administrator which normally occurs upon commencement of the insolvency proceedings.

If the debtor is not illiquid but illiquidity is only imminent, or it is over-indebted and a restructuring is not obviously futile, the debtor may apply for self- management to prepare for restructuring (InsO § 270 b). Together with the application to order this alternative, the debtor has to submit a certification issued by a specialized lawyer, tax advisor, chartered accountant, or a person with comparable skills (who must be independent from the debtor), confirming that the debtor company is not illiquid (InsO § 17) but illiquidity is only imminent (InsO § 18), or over-indebted (InsO § 19), and that restructuring is not obviously futile. The insolvency court will then issue a deadline for the party to present an insolvency plan (at the latest within three months) and will appoint a preliminary supervisor. Upon the debtor's application, the court may also permit the debtor to enter into further liabilities against the estate *(Masseverbindlichkeiten)*.

The so-called protective shield proceedings *(Schutzschirmverfahren)*, which emulates the Chapter 11 proceedings in the U.S., is conceived as an independent process of restructuring within the period between filing for petition and commencement of insolvency proceedings. This process is deemed to be finished at the time an insolvency plan is presented within a maximum period of three months.

In addition, the court has to appoint a preliminary committee of creditors if the debtor company exceeds two of three threshold values (geared to the balance sheet total, annual revenue, and the number of employees). With that, the legislature intends to strengthen the collaboration of debtors and creditors already in the preliminary insolvency proceedings.

3. Commencement of Insolvency Proceedings

a. Insolvency Order

Conditio sine qua non for any bankruptcy proceedings is firstly the expectation that the legal fees and costs associated with the insolvency proceedings can be recovered from the debtor's remaining assets. An exception applies only to natural persons, who may request a deferment of the costs of the proceedings and must then pay them off after the conclusion of the proceedings. Secondly, it is necessary that the debtor is either illiquid, impendingly illiquid, or over-indebted. If it is determined by the court (on the basis of the preliminary insolvency administrator's or other expert's opinion) that the liquidation of the debtor is not likely to generate sufficient funds to cover the insolvency expenses, the court will dismiss the petition and insolvency proceedings will not commence *(Abweisung mangels Masse)*. If both conditions are fulfilled, however, the court will order the opening by insolvency order *(Eröffnungsbeschluss)*.

b. Consequences of Bankruptcy Opening

With the opening order, the debtor loses control over its assets (if this has not already happened in the preliminary proceedings, or self-administration is granted to the debtor). The court appoints an insolvency administrator who has to be a natural person. The insolvency administrator immediately takes possession of all assets constituting the insolvency estate, and he is in charge

of the administration and management of any remaining business operations. The administrator will prepare an assets inventory as well as the creditors list.

c. Table of Registered Claims

The opening order provides a notice to the creditors inviting a registration of claims within statutory deadlines. The insolvency administrator requests the debtor's creditors to lodge a proof of debt, including proof of any claimed security rights. The registered claims will be examined as to the amount, legal merits and legal ranking. Then, the result will be communicated to the creditors in the table of registered claims. The final table contains the amount that has not been paid on the nominal value to the creditor and has the legal effect of a judgment.

d. Stay of Claim Enforcement

During the course of the bankruptcy proceedings, there is, in general, no enforcement of claims of ordinary and/or unsecured creditors *(Insolvenzgläubiger)* against the debtor. The creditors' rights depend on their security, and the time when their claims came into existence, so that there are some exceptions to the non-enforcement rule. Firstly, if an asset is owned by a third party, this party can claim separation and release of the asset *(Aussonderung)*. The creditor alleging a colorable claim may enforce its separation rights based on the grounds that an asset is not part of the mass of assets. Secondly, a creditor may enforce preferential treatment *(Absonderung)* regarding a preferential claim. This means the preferential creditor enforces its right to preferential treatment of its assets although these belong to the mass of assets. Thirdly, there is debt arising from the insolvency proceedings for the administration, liquidation, and distribution of the assets *(Masseverbindlichkeiten)*. These creditors may generally also bring an action to get payment.

Upon commencement of insolvency proceedings, pending actions against the debtor are automatically stayed. The insolvency administrator is free to resume proceedings; the creditors may do so only under certain circumstances.

e. Reorganization or Liquidation

The creditors' meeting may instruct the administrator to develop a reorganization plan *(Insolvenzplan),* which is subject to approval by the creditors and the insolvency court. The plan sets forth measures to reorganize the debtor's business. A successfully implemented reorganization plan will terminate the insolvency proceedings. With the law that entered into force on March 1, 2012, the legislature has clearly strengthened the reorganization plan procedure. The inclusion of shareholder and partnership rights in the reorganization plan, and the implementation of a debt-equity-swap are now possible. In this way, changes are brought about in the shareholder structure, which is not actually affected legally by the insolvency proceedings. Obstructing minority shareholders can thus be pushed back and previous lenders of outside capital (such as banks or suppliers) can be "brought on board" as equity capital lenders. Alternatively, if there is no successful reorganization, the assets will be sold and liquidated in order to discharge debts to the best possible extent.

The creditors' meeting has to prove material acts of liquidation. As ultima ratio, the creditors' meeting has the power to remove the insolvency administrator chosen by the court and to appoint another person.

f. Creditor Protection

The administrator may rescind legal acts and transactions of the debtor for defined statutory reasons; i.e., creditor preference, fraudulent conveyance, imbalance of performance and consideration *(Insolvenzanfechtung, etc.)*. Any benefits received through a rescinded legal act must be returned. The insolvency administrator also has to enforce total loss claims *(Gesamtschadensansprüche)*, i.e., claims against the members of the debtor company and its general managers.

g. Foreign Creditors and Debtors

Foreign creditors can be parties to German insolvency proceedings. If the insolvent debtor is subject to insolvency proceedings abroad, these proceedings

are recognized in Germany. German assets may become subject to the foreign proceedings or to separate German proceedings. These issues are governed by the European Council Regulation on Insolvency Proceedings.

4. Conclusion of the Insolvency Proceeding

Following the distribution of proceeds to the creditors, or after approval of a reorganization plan, the court will order the completion of the proceedings. Supervision of outstanding reorganization measures may be ordered. After the insolvency proceedings are finished, the debtor will be erased from the companies register and registered in the debtors list *(Schuldnerverzeichnis)*.

Useful links:
- www.insolvenz-ratgeber.de
- www.insolvenzbekanntmachungen.de

XII. Taxation

As a highly developed country in the center of Europe with a global economy, Germany has a sophisticated domestic tax system and an extensive network of international tax treaties. Since 2008, Germany's corporate tax system has been a dividend exemption system with rather low corporate income and trade tax rates. Just as in other jurisdictions of developed countries, the German tax system is subject to frequent changes. Changes within the last years range from the reform of the taxation of mutual funds (open-end funds), preservation of tax losses in case of a change of control of corporations to the increased digitalization of taxation procedures. As reaction to the so-called Panama papers, documents revealing information about offshore and shell companies in tax havens, the German government intends to increase the information filing requirements for German domestic taxpayers.

The following summary provides a general overview of some key aspects of German taxation. German domestic tax counsel should always be involved to avoid adverse tax implications and to reconfirm the scope and ramifications of relevant German tax laws. This especially holds true in light of the frequently changing tax environment.

1. Taxation of Individuals

German resident individuals are subject to German income tax *(Einkommensteuer)* based on their worldwide income (subject to limitations of applicable income tax treaties).

Non-German resident individuals are subject to German income tax based on their income from German sources (subject to limitations of applicable income tax treaties). Such German sources are, for instance, income from German permanent establishments, dividends received from German resident corporations, lease income from German real estate, capital gains resulting from a sale of such real estate, income derived from the performance of personal services, wages and salaries from employments exercised in Germany.

C

German resident individuals are taxed at a progressive tax rate presently ranging from a personal income tax rate of 14% to a maximum personal income tax rate (for taxpayers with taxable income in the 2017 tax year of more than €256,304.00 and married taxpayers filing jointly of more than €512,608.00) of 45%. Germany levies an additional surcharge tax of 5.5% of the amount of personal income tax ("Solidarity Surcharge," originally introduced to finance Germany's reunification in 1990). The maximum overall marginal tax rate, therefore, amounts to 47.475%. In addition, the German revenue service collects, on behalf of recognized religious bodies, a church tax from individuals who are a member of the relevant church that is entitled to church tax revenues. In most of the German Federal States *(Bundesländer)*, the church tax rate amounts to 9% of the income tax amount. The church tax is a deductible item for the determination of the personal income tax base.

A flat rate tax *(Abgeltungssteuer)* of 25% (plus 5.5% Solidarity Surcharge thereof, i.e., 26.375% in total, plus church tax, if applicable) applies to income from capital investments, e.g., interest payments and capital gains derived from stock, receivables and certain financial instruments. If a taxpayer owns at least 1% of the nominal capital of a corporation at any time within a five-year period prior to the disposal of the participation, however, 60% of the capital gain is subject to the individual personal income tax rate (see above). Further exceptions to the application of the flat rate tax exist. This includes, under certain circumstances, the opportunity to opt into the ordinary tax regime for income from capital investments. Exercising the option may provide benefits in case substantial expenses are incurred in connection with such income, e.g., in case of a debt-financed acquisition.

Income of non-German residents from German sources, such as, German permanent establishments (branch operations, partnerships, or certain other legal forms of doing business), from real estate, employment or independent personal services, is subject to the same personal income tax rates as income of German residents. Other sources of income, e.g., from dividends or license fees, are subject to a withholding tax at tax rates ranging from presently 15% to 25% (plus 5.5% Solidarity Surcharge on the income tax amount levied and church tax, if applicable).

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The taxation of German resident individuals on foreign income and of non-German resident individuals on income from German sources may be limited by applicable income tax treaties (see below).

Germany has negotiated and entered into a wide range of (income) tax treaties which limit the ability of the German revenue service to tax non-German source or even German source income (e.g., limiting or eliminating the ability to levy withholding taxes). A withholding tax reduction under a treaty requires an application for a withholding tax exemption or reduction certificate. Otherwise, withholding taxes levied in excess of applicable income tax treaty restrictions or, for instance, limitations under the EU Parent-Subsidiary Directive, will be refunded upon application to the Federal Tax Office *(Bundeszentralamt für Steuern)*.

A trade tax *(Gewerbesteuer)* applies to income of German and non-German resident individuals derived from business or trade of a German permanent establishment. Trade tax is based on taxable income as determined for personal income tax purposes, subject to certain adjustments. For instance, the trade tax deductibility of certain business expenses, such as interest expenses, lease or rental expenses, license and royalty fee expenses, is limited. The trade tax rate is derived from a base tax rate and a multiplier fixed by the municipality in which the taxpayer carries on its trade or business. In case the trade or business is operated through permanent establishments in several municipalities, the trade tax basis is apportioned among the relevant municipalities. The trade tax rate varies within Germany as result of the multiplier fixed by the municipalities. The statutory trade tax rates generally range from approximately 7% to about 18%, depending on the municipality. The average statutory rate of approximately 15% generally applies to permanent establishments located in larger cities and highly populated regions. Trade tax is not a tax-deductible business expense.

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Within certain limitations, trade tax can be credited against the personal income tax levied on trade income. Excess trade tax credit will, however, neither lead to income tax refunds nor carry-forwards.

2. Taxation of Business Entities

a. Taxation of Incorporated Businesses (Stock Corporations and Limited Liability Companies)

Incorporated German resident business operations, such as stock corporations *(Aktiengesellschaft – AG)* and limited liability companies *(Gesellschaft mit beschränkter Haftung – GmbH)*, are subject to corporate income tax *(Körperschaftsteuer)* with their worldwide income (subject to limitations of applicable (income) tax treaties). Incorporated businesses are considered tax-resident in Germany if they maintain their statutory seat or effective place of management in Germany. Non-German resident incorporated businesses are subject to German corporate income tax with their German source income (e.g., from a German permanent establishment or branch office).

The corporate income tax rate amounts to 15% regardless of whether the income is distributed or retained. The Solidarity Surcharge of 5.5% of the corporate tax amount is also levied on corporate income tax. This leads to a combined statutory corporate tax rate of 15.825%.

In addition, German resident incorporated businesses or non-German resident incorporated businesses maintaining a German permanent establishment are subject to trade tax on their income at statutory trade tax rates ranging from approximately 7% to 18%, depending on the municipality in which the incorporated business conducts its business through a permanent establishment. Again, the average statutory trade tax rate is approximately 15% in cities and highly populated regions. Trade tax is not a tax-deductible business expense.

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The average overall income tax rate for incorporated businesses is approximately 30% (depending on the local trade tax multiplier in a range between approximately 22.83% through 33.83%).

Dividends received by a German resident incorporated business from a German or non-German resident incorporated subsidiary, or dividends received by a non-German incorporated business from a German incorporated subsidiary, are exempt from corporate income tax provided that the direct shareholding in such subsidiary amounted to at least 10% at the beginning of the calendar year. An amount equal to 5% of the gross dividend amount is deemed a non-tax deductible business expense, however. For trade tax purposes, this effective 95% tax exemption only applies if the incorporated business owns directly or indirectly at least 15% of the nominal capital of the subsidiary at the beginning of the fiscal year. The trade tax exemption for dividends from non-German resident incorporated business applies if, in addition, (i) the parent company maintains aforesaid participation threshold at least until it receives the dividend distribution and (ii) the subsidiary generates almost exclusively active income.

A withholding tax of 25% plus 5.5% Solidarity Surcharge (26.375% in total) applies to dividends paid to the shareholders of German incorporated businesses. Domestic corporate shareholders are generally eligible for a withholding tax credit against their corporate income tax burden. For German resident taxpayers, excess withholding tax credits will lead to a tax refund. Under certain conditions, EU corporate shareholders are exempt from withholding tax under the EU Parent-Subsidiary Directive. Other non-German resident shareholders may be eligible for a reduced withholding tax rate, or exemption under an applicable income tax treaty (see below).

Capital gains resulting from the sale of share(s) in an incorporated business by a corporate shareholder are generally exempt from corporate income tax and trade tax. An amount equal to 5% of such capital gain is deemed to be a non-tax deductible business expense. Consequently, only 95% of capital gains are

effectively tax-exempt. Said tax exemption for capital gains is not available for banks, financial institutions, insurance companies, pension funds and certain holding and finance companies with banks or financial institutions as majority shareholders.

An incorporated business having its effective place of management in Germany and its statutory seat in the EEA (including Germany) may form with its shareholder a (corporate) income tax and trade tax group *(ertragsteuerliche Organschaft)* with a German trade or business (individual, partnership or incorporated business). Besides other formal requirements, a profit and loss transfer agreement has to be concluded for a minimum term of five years. As a result of the tax group, the members of the tax group are, in principle, taxed as one entity. This allows, for instance, netting of profits and losses between the tax group members. The taxable income of the members of the tax group, including the head of the tax group, is accumulated and not consolidated, however. A tax group is often used in acquisition structuring to achieve set-off of operating profits with financing expenses (effect of a debt push down). Yet, limitations on the tax deductibility of interest expenses have to be considered (see below).

b. Taxation of Partnerships and Civil Law Societies

German general and limited partnerships *(Offene Handelsgesellschaft – OHG, Kommanditgesellschaft – KG)* as well as civil law societies *(Gesellschaft bürgerlichen Rechts – GbR)* are treated as tax "transparent" for personal income tax and corporate income tax purposes. For personal and corporate income tax purposes, the income generated by the partnership or civil law societies is allocated to its (individual or corporate) partners and is taxed at the level of the respective partner in accordance with the rules outlined above.

For German trade tax purposes, a partnership or civil law society that is engaged in a trade or business and maintains a German permanent establishment is, by itself, liable for trade tax. German resident and non-German resident individuals who are partners of the partnership or civil law society are, within certain limitations, eligible for a trade tax credit against their German personal income tax resulting from trade and business income (see above). Excess trade tax credits will, however, neither lead to income tax refunds nor carry-forwards.

3. Tax Losses

Tax losses may be carried forward for an indefinite time. For income tax and corporate income tax purposes, a one-year tax loss carry-back is available.

The maximum carry-back amount is limited to €1 million (€2 million for married taxpayers filing jointly). Under the German minimum taxation rules, in any given year only €1 million (€2 million for married taxpayers filing jointly) plus 60% of the taxable income exceeding the €1 million threshold may be offset against available tax loss carry-forwards. The minimum taxation rules apply to all taxpayers regardless of their legal form. Additional limitations apply, for instance, in case of direct or indirect ownership changes of incorporated businesses, partnerships and civil law societies. Available tax losses and tax loss carry-forwards may be partly or entirely forfeited (change of control rules). As result of a recent tax law change, tax loss carryforwards may now be carried forward and may be utilized even in a change of control situation, if the business is continued for a period of three tax years. Please note that, for instance, the establishment of a (corporate) income tax and trade tax group is considered a discontinuation of the business. In case of reorganizations, e.g., mergers or demergers, tax losses and tax loss carry-forwards do not transfer to the receiving entity. Also in case of individuals, tax losses and tax losses carried forward do not pass over to the heirs in case of death.

4. Limitations on Tax Deductibility for Interest, Expenses, German Earning Stripping Rules

Under the German earning stripping rules, the tax deduction for net interest expenses of €3 million (de minimis threshold), or more, is generally limited to

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30% of the relevant tax EBITDA. Net interest expense is the amount of interest expenses reduced by the amount of interest income (i.e., interest expenses for a shareholder loan or third-party financing are at least tax deductible under the earning stripping rule limitation to the extent of interest income, e.g., for bank deposits). The term interest expenses includes all interest expenses, regardless of whether or not they are owed to a related or to a third party. In addition, no distinction is made between short-term and long-term debt. The relevant tax EBITDA is defined as 30% of the taxable income adjusted by interest income and expenses as well as depreciation, amortization and an EBITDA carry-forward, if available.

To the extent the earning stripping rules apply, unutilized tax EBITDA amounts are carried forward for a period of up to five fiscal years. Any net interest expense which is not tax-deductible under the German earning stripping rules is carriedforward for an unlimited time and may be deducted in future fiscal years within the limitations of the German earning stripping rules. In case of reorganizations or ownership changes of companies, the interest carry-forward as well as the tax EBITDA carry-forward may be forfeited.

The German earning stripping rules do not apply (i) in case the net interest expenses amount to less than €3 million, (ii) to companies that are not part of a controlled group and (iii) where the equity ratio of a business that is part of a controlled group is not more than 2% lower than that of the entire controlled group (equity ratio according to IFRS or, alternatively, German or US GAAP). Equity ratio is defined as the ratio of equity versus balance sheet total. For purposes of the equity ratio test, equity is reduced by the book values of shares in incorporated subsidiaries.

5. Tax Treaties, Foreign Tax Relief

Germany has an extensive network of tax treaties covering over 90 countries including all European countries, the U.S.A., the Russian Federation, China, and India. These tax treaties usually exempt income derived from foreign real estate and foreign permanent establishments from German income taxation and grant a reduction of or exemption from German withholding taxes (e.g., on dividends). In addition, Germany has negotiated a wide range of treaties for the exchange of tax information, e.g., with treaty partners such as the Bahamas, Bermuda, BVIs, Cayman Islands, St. Lucia, and the Grenadines, and actively participates in the OECD.

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German tax residents are generally subject to German taxation with their worldwide income. To mitigate potential double taxation (in case no income tax treaty is in place), a tax credit is available for foreign income taxes paid, however, subject to a per country limitation. Alternatively, such foreign taxes may be deducted as tax-deductible business expenses.

6. Transfer Pricing, Controlled Foreign Companies (CFC)

Transfer prices for goods and services exchanged between German tax-resident companies or branches and their non-German resident affiliates must comply with the arm's length principle. Detailed transfer pricing documentation rules have to be observed. Violation of these rules may result in substantial penalties and adjustments of the taxable income to the detriment of the German taxpayer. The arm's length principle also applies to transactions between German resident affiliates. In such cases, however, the transfer pricing documentation rules are not applicable.

Special provisions apply to "outbound transfers of business functions" from a German taxpayer to a non-German resident affiliated entity or person. Therefore, German transfer pricing rules and documentation requirements have to be observed, for instance, in connection with the change in a group's supply chain or the activities performed in Germany and outside Germany. Contemporaneous documentation is generally not required; extraordinary transactions have to be documented within six months from the end of the financial year in which the transaction took place, however.

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Germany has a CFC regime to protect the German tax revenue from the artificial diversion of German profits to overseas companies that are controlled from Germany and are located in a low-tax jurisdiction. Exemptions apply in case the CFC is tax-resident in the EU or the EEA.

7. Value Added Tax (VAT)

The most important indirect tax in Germany is the value-added tax or sales tax *(*VAT, *Umsatzsteuer)*, which applies similarly in all countries in the EU. The ordinary VAT rate in Germany amounts to 19%, which is below the average EU standard VAT rate. The reduced VAT rate applicable in certain product and service sectors amounts to 7%. VAT is applied to both goods and services supplied by a VAT entrepreneur. VAT is primarily a tax on consumption, therefore, as a general rule, it does not affect a business as cost item. To the extent that a business is subject to VAT on taxable supplies, it should generally be able to recover VAT incurred upon its own purchases of goods and services (deduction of input VAT). Certain supplies are exempt from VAT. Correspondingly, no input VAT deduction is available for related sales and supplies. This might, for instance, result in higher costs for banks and insurance companies, certain real estate lessors (especially residential real estate and real estate leased to banks and insurance companies) or passive holding companies.

Government VAT revenues account for the highest portion of German tax revenues. Therefore, compliance with applicable VAT rules is audited frequently by the German tax authorities. Adequate attention should be paid to the observation of these rules in order to avoid the assessment of VAT adjustments and resulting default interest which may, in the case of VAT, easily reach quite substantial amounts.

8. Other Taxes

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Germany levies several other taxes, and applies a number of special tax collection methods, e.g., 15% withholding tax applicable for payments made as consideration for construction work *(Bauabzugsteuer)*. A real estate transfer tax *(Grunderwerbsteuer)* in the range between 3.5% and 6.5% of the property purchase price (depending on the Federal State in which the real estate is located) is payable in relation to a transfer of title in real estate located in Germany. Real estate transfer tax may also be incurred in case of a direct or indirect ownership change in a real estate-owning business. This can also be relevant for intra-group share transfers taking place at a higher level of the group structure and outside Germany. The tax authorities must be notified of the relevant transaction within a deadline of two weeks. Germany also levies a real property tax *(Grundsteuer)*, an insurance tax *(Versicherungssteuer)*, and a number of other taxes (e.g., energy tax and mineral oil tax). There is also an inheritance and gift tax.

Useful links:

- www.bundesfinanzministerium.de
- www.bundesfinanzhof.de

XIII. Tax Fraud and Prevention

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1. The System of Responsibility in Tax Matters

German procedural tax law imposes the responsibility for tax obligations, especially tax filing, on the board of directors (management, officers) as the representatives of a corporation. In case of an internal assignment of responsibility, the responsibility is with the specific registered manager who has been assigned the responsibility for a given kind of tax. Generally, the CFO bears the main responsibilities but there are other board members with special responsibilities: HR is responsible for payroll taxes, sales/logistics is generally responsible for customs.

The responsibility is imposed to board members irrespective of residence. Therefore, in any case of misconduct, a board member with a residence outside Germany would be likewise personally responsible. That applies not only to liabilities based on administrative offense law, but also to criminal tax law.

Generally, the board delegates the administration of tax filings to internal departments in charge of tax, payroll/HR, logistics, accounting, or externally to shared service centers (SSC) or advisors. In any of these cases, the final responsibility will remain with the board. The board is responsible for organizíng the chain of command and the processes to ensure that all facts are known by the departments or external service provider. The party responsible by delegation will be identified, allocated and communicated to all delegates and considered in the respective filing.

In Germany, criminal responsibility applies to individuals only. Corporations can only be liable if provided in the administrative offense law.

Criminal offenses in tax matters will be prosecuted by the fiscal authorities in a special prosecution department named *„Buß- und Strafsachenstelle"* – or by the public prosecutor office. These prosecutors will generally be supported by the tax police *(Steuerfahndung)* which is an internal department of the fiscal authorities as well.

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An individual will be liable if he or she acted with at least limited intent. To start proceedings, probability or strong suspicion is not necessary. It is crucial that

- tax was not filed correctly and was underpaid;
- that the misconduct was known by the individual (at least limited intent), and
- the individual took into account that its conduct can result in a tax shortfall.

Since the individuals representing the executive board will personally sign the respective tax declarations, they will likely be held liable for the misconduct in the first instance. There is a tendency that prosecutors and courts focus proceedings on the executive board as these individuals are named in the corporate register. In case there is a properly organized delegation of responsibility to an internal department, the responsibility may pass to the respective head of that department. Likewise, if relevant misconduct was committed by an individual without knowledge of the board or other responsible parties in the company, the prosecution may concentrate on such individuals only.

In the event of criminal tax proceedings, the personal risk for the offender(s) is fine or imprisonment (up to five years). In certain cases, as described by the German administrative tax law, the personal risk may be higher (imprisonment between six months and ten years). This applies, for instance, to cases involving high tax amounts *("großes Ausmaß")* which can have a significant financial impact on a business. The Federal Court of Justice has recently ruled that a tax amount of €50,000 or more will constitute *"großes Ausmaß."* This amount can be easily reached in the sector of corporate taxes.

Based on German administrative offense law *(Recht der Ordnungswidrigkeiten)*, in a case of organizational misconduct, the liable party can be the company as such. This corporate responsibility is often in the focus of the prosecutor if the offense relates to taxes. That motivates corporations to implement internal control systems to manage these risks properly, particularly with a view to the fact that tax prosecutors tend to argue that any lack of internal control may be considered organizational misconduct.

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2. The Requirements for Impunity (by Voluntary Disclosure, § 371 AO)

German administrative tax law grants impunity to the offender in case of voluntary full disclosure of a given tax evasion. The prerequisites for impunity have recently been tightened considerably by the Federal Court of Justice, and as a consequence of legislation:

Completeness

The relevant facts constituting tax evasion must be disclosed promptly. If the disclosure is incomplete, the offender will not be granted impunity at all.

Disclosure for non-time-barred years, at least for the last ten years

The disclosure must comprise all tax years not yet time-barred, at least the last ten years. Prior to a recent change in legislation, it was sufficient to disclose the facts for the years that were not barred for criminal proceedings which was generally five years. The recent change synchronized the voluntary disclosure provisions with the ten-year limitation period applicable to tax evasion cases.

Blocking Provisions

Especially for corporations, the blocking provisions restricting impunity will have a major impact. These provisions have been tightened in recent years which means it became more difficult for responsible managerial personnel to benefit from impunity. Implementing appropriate internal controls may help to curtail these risks.

Impunity will be blocked if one of the following occurs prior to the filing of a voluntary disclosure:

- A tax audit order is delivered to the offender, the tax payer or its representative;
- It has been announced to the offender or its representative that criminal proceedings have commenced;
- A tax auditor turns up to start a tax audit;
- A representative of the tax authority turns up to start investigating a tax evasion or administrative tax offense;
- A representative of the tax authority turns up to inspect facts regarding VAT or payroll taxes;
- The tax evasion was already detected by the tax authority and the offender should have known this at the time of filing the disclosure;
- The tax amount evaded exceeds €25,000 per case.

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Possibility to obtain impunity despite of large tax evasion (§ 398a AO) by making a surcharge payment

If the impunity is blocked because the tax amount evaded exceeds €25,000, the offender may still reach impunity if it pays a surcharge. The amount of the surcharge depends on the amount of the evaded tax:

- 10% up to a threshold of €100,000
- 15% between €100,000 and €1,000,000
- 20% above €1,000,000

The surcharge must be paid by the offender personally. In case of several offenders (board of directors) the surcharge must be paid by every single director.

3. The Amendment of a Tax Return Declaration – a Systematic Overview

Tax return declarations can be amended in different ways:

a) Mandatory amendment in case of good faith (§ 153 AO)
If the taxpayer detects after filing a tax return that its declaration is not compliant, it must amend the declaration promptly (10 days max. after detection). The taxpayer must inform the tax office within this timeframe and amend the declaration thereafter.

b) Voluntary amendment in case of gross negligence or intent
In any case the taxpayer acted with gross negligence or intent at the time of filing, it may file a voluntary disclosure of the defect.

Questions of Demarcation

As both kinds of an amendment will be filed with, and judged by, the tax office, it is very important to anticipate the outcome of such review in the light of the different legal conditions applicable to these two kinds of amendments. Taxpayers disregarding these differences may find themselves exposed to criminal offense charges if the tax office interprets the amendment as a voluntary amendment involving gross negligence or intent, even though this was not considered by the taxpayer.

In case of corporate taxes, there may be situations in which both kinds of amendments may apply (e.g., the executive board has acted in good faith, the head of the department that is responsible for collecting the facts and prepare the filing acted in gross negligence/intent). In these cases, both amendment regimes should be coordinated so as to at least avoid negative publicity for the corporation.

4. The Controllability of Individual Liability with Internal Control Systems (ICS) and Content Management Systems (CMS)

Taking the above into account, corporations and their management should have a strong interest to reduce personal liability relating to tax obligations. Not only because tax proceedings often trigger public interest (reputational risk), but also because tax disclosures may often relate to big numbers which drive the personal risk for management.

Based on recent developments in tax law, management may become exposed to criminal charges if there is organizational misconduct involved in tax matters.

If this is accompanied by systematical faults and/or high tax shortenings, it may be impossible for management to argue that it acted in good faith when signing the respective tax declaration. In the light of this situation, many tax and legal advisors feel that the voluntary disclosure provisions no longer work properly for corporations.

In response, the Federal Ministry of Finance recently published a revised interpretation rule regarding the application of mandatory disclosures (§ 153 AO) especially for corporations. Based on that, the tax administration will in the first instance treat disclosures as mandatory and not as voluntary if the corporation runs an effective internal control system for tax matters, at least for the tax sector in question. Internal control systems are implemented by managing boards to properly organize the chain of command, the responsibilities for decisive parts of a process, and the related controls and – in consequence – to reduce the risks for the corporation and the managing board to become liable for misconduct. As tax matters involve many departments within a corporation, it is vital for every general manager to make sure an internal control system is in place in order to properly manage the tax risks of the corporation and – of course – any personal risks.

XIV. Customs and Excise

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Since the beginning of 1993, the EU Member States – except a few territories – have formed a single internal market, without any customs and similar duties on the movement of goods between EU Member States. Customs duties apply only in the case of an import of goods into the area of the EU. The European Union Customs Code (Regulation EU No 952/2013 of October 9, 2013) entered into force on June 1, 2016. It is directly applicable in all EU Member States, and forms the main legal basis of customs in the EU. Based on this Regulation, the EU Commission can adopt further rules governing customs details. Further, the Member States may also adopt national rules in order to complete the legal framework.

1. Import of Goods

If goods are imported into the customs territory of the EU, they must be released by the customs authorities for free circulation within the EU. This requires customs clearance upon customs declaration, either at the border of the EU territory or at any customs office within the EU. In the latter case, special proceedings apply relating to the transport of goods under customs supervision from the border to the inland customs office.

Customs clearance involves a declaration of the goods and their value to enable the customs authorities to calculate and levy import charges (duties, import VAT and, if applicable, special excise duties).

The framework of duty rates is governed by the Common Customs Tariff (Council Regulation No. 2658/87 of July 23, 1987). Annually, the European Commission fixes the amounts of the relevant rates. The Common Customs Tariff is based on the Combined Nomenclature (CN) representing a harmonized tariff system and a statistical nomenclature. The structure of the system is based on the Harmonized System (HS) issued by the World Customs Organization. The HS system, together with the EU extensions, is published as Integrated Tariff of the European Communities, the so-called TARIC code. It lists all the goods that can become the subject matter of an import. The duty must be paid upon import or, in case of customs clearance inside the EU, at the time of declaration. If freight forwarders or other representatives arrange for customs clearance, duties are due within ten days. Upon application, the deadline can be extended to thirty days, subject to a security deposit (bail).

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The import of goods may be subject to restrictions such as import prohibitions or special permit requirements. This can affect agricultural products, waste, medical products, chemicals and certain other goods.

2. Special Proceedings of Relief

Goods may be stored without customs clearance in a customs warehouse for an unlimited period. This way, goods originating from a third country can be in transit within the EU without becoming exposed to import duties. In case of an import (removal from the customs warehouse for import purposes), customs duties become payable when the goods are removed from the warehouse. Trade restrictions such as import authorization requirements or import licenses are not applicable during storage in a customs warehouse. A special permit is required in the event the importer intends to place imported goods in a warehouse operated by such importer. If no such permit is available, the goods must be placed in a customs warehouse operated by a third party forwarder or other professional warehouse keeper.

If goods are imported for short-term temporary use within the EU, special temporary admission proceedings may apply. If the pertinent permit is granted, no regular customs duties are payable. These goods may not be changed while used in the EU. The importer must intend from the beginning to re-export the goods after completion of the temporary use.

If goods are moved into the territory of the EU for processing purposes and are subsequently re-exported, the inward processing relief system may apply. In that case, no import duties would be levied.

The same can apply for goods processed outside the EU which are subsequently re-imported under the outward processing relief system. Goods exported for processing purposes and subsequently re-imported are subject to a reduced customs value which reduces the customs duty.

Finally, it is also possible to import non-EU goods at a lower rate of duty if the import takes place for processing in the EU. This procedure applies to goods which after processing are subject to a lower import duty than the duty applicable to the imported unprocessed goods. It also applies if the goods are processed in accordance with certain technical requirements before released to free circulation. The processing itself is monitored by the customs authorities.

3. Binding Tariff Information (BTI)

Regarding goods from non-EU countries intended to be imported into the EU, importers can ask their local customs authority for binding information on the applicable tariff. That information is binding for all customs authorities in the EU. The EU Commission operates an online data service platform which publishes binding customs tariff information. Classified information of applicants will remain confidentiual and will not be published. A binding tariff information is generally valid for three years. It gives the importer advance legal certainty as to the correct classification and customs tariff of a given kind of goods.

4. Authorized Economic Operator (AEO)

Importers and other parties working under special customs proceedings may apply for the status of an Authorized Economic Operator (AEO). That status provides certain advantages as to easier admittance to customs simplification, fewer physical and document-based controls, prior notification in case of an inspection, the possibility to request a specific place for inspection, and certain indirect benefits resulting from the treatment and naming as secure and safe business partner. The latter is a key element of the World Customs Organization (WCO) to establish a safe framework of standards to strengthen the security of the supply chain. The concept of the AEO is based on the customs-to-business partnership introduced by the WCO. It is also recognized by the EU. The AEO status is honored by all EU Member States plus Norway, Switzerland, Japan, Andorra, the U.S., and China. Further negotiations regarding the acceptance of the AEO status by other countries are pending.

5. Excise Duties

Based on EU Directives, all EU Member States must levy excise duties on alcohol, tobacco and energy (fuels and electricity). These EU Directives determine the relevant product categories, minimum rates, possible exemptions and general rules for the production, storage and movement from one EU country to another. The transportation is supervised by the electronic Excise Movement and Control System (EMCS) if the transportation is under duty suspension. The system ensures that the duties are levied at the final destination of its consumption.

Additionally, Germany levies excise duties on coffee.

In case of import, the excise duties become payable in addition to customs duty.

6. Value Added Tax (VAT)

In case of an import into the EU, the imported goods are free of VAT. VAT is levied on imports as if it were normal revenue. It is called “Import VAT” and is subject to customs procedures.

Useful links

- www.zoll.de
- www.ec-europa.eu/taxation_customs
- www.bundesfinanzministerium.de

XV. White Collar Crime, Business Criminal Law

D

Criminal law is a political control instrument to enforce criminal sanctions in business crime situations in Germany and it is effectively used.

1. Overview of Relevant White Collar Crime

Uniform codification of business criminal law does not exist in Germany. The legislator included particularly relevant white collar crime offenses in the German Criminal Code *(Strafgesetzbuch – StGB)*, which marks the center of German penal legislation. The Criminal Code includes, among others, criminal offenses against assets (in particular, fraud and breach of trust), corruption offenses (bribery, passive corruption, accepting advantages, etc.), environmental offenses (water, air, soil pollution, etc.), and money laundering (see link at the end of the chapter).

In addition, further penal provisions are found in various business laws, such as rules relating to insider trading and market manipulations (Securities Trading Act – *Wertpapierhandelsgesetz – WpHG*), betrayal of secrets and industrial espionage (Law Against Unfair Competition – *Gesetz gegen den unlauteren Wettbewerb – UWG*), operation of illicit banking transactions (Banking Act – *Kreditwesengesetz – KWG*), or preferential treatment of work council members (Works Constitution Act – *Betriebsverfassungsgesetz – BetrVG*). Further criminal offenses are included for instance in the Stock Corporation Act *(Aktiengesetz – AktG)* and the Insolvency Code *(Insolvenzordnung – InsO)*.

Members of a stock corporation's board of management, and of a limited liability company's management, can be held responsible for criminal offenses of subordinated employees: If the offense was made possible, or even only facilitated, by lack of supervision, the supervising superior is exposed to the risk of a fine of up to €1 million. If the superior realizes that an employee commits criminal offenses continually, he is obligated to intervene. Otherwise, his conduct may be punishable because of aiding and abetting regarding the employee's criminal offenses. The Federal Court of Justice decided recently that such an intervention obligation also applies to the compliance officer of an enterprise.

2. Sanction System and Responsible Authorities

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Germany has a dual criminal law system: Serious misconduct – a criminal offense – is punishable by monetary fine and imprisonment, while less serious offenses – administrative offenses – are punishable by fines.

Criminal penalties are intended for natural persons. That does not mean, however, that enterprises cannot be sanctioned under German law. (Administrative) fines of up to €10 million can be imposed on companies whose employee committed a criminal offense or an administrative offense that violated the company's obligations or which enriched or intended to enrich the company. For specific violations (esp. antitrust or market abuse), administrative fines can be up to €15 million or 15% of the company's revenue.

In addition to punishments and fines, there are typically further legal consequences: It is customary to impose levies on what has been obtained by the offense, and instrumentalities and products of the criminal offense can be attached or confiscated.

If a company was enriched by the offense, it may be punishable by confiscation of the profit generated by the offense.

The 115 German public prosecutor's offices are regularly responsible for the pursuit and prosecution of criminal offenses, in special cases financial or customs authorities are responsible. These are obliged to intervene if there is suspicion that a criminal offense has been committed (referred to as legality principle). For the prosecution of economic crimes, public prosecutor's offices with a special focus have been established which have special experience and know-how in the field of business criminal law, in particular economically trained specialized advisors.

After conclusion of an investigation, the prosecution authorities either terminate proceedings or file charges at a criminal court. Prosecution authorities may terminate proceedings conditionally upon fulfillment of certain conditions. In white collar criminal proceedings, these are regularly monetary conditions, whereby

the amount of the imposed payment is at the discretion of the prosecution authorities. Guilt is not established if proceedings against monetary conditions are terminated against payment of a given amount of money.

If a criminal charge is filed, a public trial follows which ends with the sentencing or acquittal of the accused. Instead of filing criminal charges, a public prosecutor's office may also request an order for summary punishment which is to be issued by a criminal court without trial. This is only possible in cases subject to monetary fine or imprisonment up to one year. Only courts can sentence an accused for a criminal conduct. Depending on the level of severity of the crime, the competent court of first instance is a single judge at the local court or a court composed of one or more judges and laymen at the regional court. The regional courts have court divisions specialized in business offenses. They are responsible for the offenses designated in Section 74c Court Constitution Act *(Gerichtsverfassungsgesetz – GVG)* (see link at the end of the chapter). The five penal chambers of the Federal Court of Justice sit on cases in the last instance.

Competent administrative authorities are responsible for the pursuit of administrative offenses. Unlike criminal prosecution authorities, they are not subject to the legality principle but decide at their own discretion whether to pursue misdemeanors as administrative offenses (referred to as opportunity principle). They then decide on their own on the imposition of penalties. Criminal sanctions are decided upon by the aforementioned criminal courts.

3. Avoiding Misconduct, Compliance

If a preliminary investigation has been initiated, it makes sense – not only for the accused individuals but possibly also for the company – to retain defense counsel specializing in white collar crime.

Companies are obliged to implement compliance measures to avoid employees' misconduct. Otherwise, directors, supervisors and managers and the company itself can be held reliable for illegal behavior of the company's staff (see Chapter 2 – Sanction System and Responsible Authorities).

Self-regulatory compliance enforcement measures are often guided by national law, and help to avoid criminal proceedings. A business organization and re- porting structure that provides for reporting lines which bypass the relevant national management bodies is not recommended and involves substantial risks. If there are deficiencies in a business's responsibility and reporting structure (involving lack of appropriate compliance measures), the business and its management are at risk and may be exposed to sanctions under German law. In addition, substantial cost is associated with criminal proceedings.

Classic areas of compliance measures relate to the sectors of corruption and cartels, combating money laundering, capital markets (esp. avoiding insider trading and market manipulation), tax compliance, and finally payments which are not regular considerations (e.g., in the context of donations and sponsoring for promotional purposes).

Listed companies must adhere to the sometimes confusingly complex rules on securities trading in European law. This comprises not only the prevention of market manipulation and insider trading, but also compliance with publicity regulations.

Appropriate information to and training of employees, as well as monitoring strict compliance with internal self-regulatory guidelines (codes of conduct) are important measures to control compliance-related risks. If there is deficient supervision and organization (commonly referred to as a supervision and organization fault), the management, senior employees as well as the company itself are exposed to civil and criminal risks.

Useful links:

- https://www.gesetze-im-internet.de/englisch_stgb/index.html
- https://www.gesetze-im-internet.de/englisch_gvg/englisch_gvg.html#p0398

XVI. Principles of Public Administration

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The German Constitution (*Grundgesetz*; Basic Law) stipulates that public administration is bound by the rule of law (rule of law principle). The rule of law principle means that measures taken by the government or administration may not violate valid legislation (lawfulness principle). Secondly, government and administration may act only if a law empowers them to do so. In cases of doubt, own judgment must be applied in accordance with the underlying legal principles. Excessive acts are illegal. Any act must be in appropriate proportion to the intended result.

1. Organization of Public Administration

Because Germany is a federal nation, administrative tasks are divided in three tiers between the federal level *(Bund, Federation)*, the States *(Länder)* and the municipalities.

- The *Bund* carries out tasks, which are allocated to the federal level, e.g., foreign relations, the armed forces and specific federal tasks for which federal bodies or institutions, under the command and instructions of a federal ministry, are responsible. The federal ministries have policy tasks, preparing legislation and issuing the required ordinances and administrative regulations. The federal ministries are the highest administrative bodies of the Bund.
- The *Länder* carry out the non-federal administrative tasks on behalf of the Bund or under their own responsibility. They are responsible for legislation and administration in the areas of education, science and culture, public law and order, security and regional planning. There are highest level Land authorities, higher Land authorities and central Land authorities, as well as legal entities.
- The *Bund* and the *Länder* allocate tasks and appropriate funds to the municipalities. They practice self-administration, carrying out their own and voluntary tasks according to their own judgment and financial possibilities.

2. Administrative Tasks

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The tasks of the public authorities deal with public safety and order, services and planning.

- Administration of public safety and order is exercised by the police, the customs authority, the shop and factory inspectorates, and the fiscal revenue offices. These authorities serve to maintain public safety and order.
- Administration of services provides citizens and businesses with public services.
  These include kindergartens, schools, universities, youth care homes, public transport, waste removal, electricity, gas and wastewater plants.
- The planning authorities produce e.g., zoning and development plans as the basis for construction of industrial plants, commercial enterprises and residential buildings. Environmental protection is another key task of the state requiring advance planning. As an example, the environment must be taken into account when planning rail routes, highways, airports, waste combustion plants, and landfill waste disposal sites (see section on Environmental, Health and Safety Law below).

3. Administrative Procedure

Administrative procedure rules are enshrined in the Federal Public Administrative Procedures Act *(Verwaltungsverfahrensgesetz des Bundes)* as well as the practically identical Public Administrative Procedures Laws of the *Länder*. This Act and the state laws define administrative procedure as any activity of a public authority which is aiming to adopt an administrative decision or to conclude a public law agreement.

- By means of an administrative decision *(Verwaltungsakt)*, an authority can issue binding regulations for individual cases, e.g., permit the construction of a commercial building, order the closure of an industrial plant damaging

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the environment, or grant state subsidies. Because administrative decisions are still the most important instrument of public administration, the Administrative Procedures Acts contain detailed stipulations on the issuing, validity and possible cancelation of an administrative decision.

- Rather than issuing an administrative decision unilaterally, an authority may also conclude a bilateral public law agreement. For example, a public body can order the removal of environmental contamination by the party which has caused the contamination. This may be done by means of an administrative decision. A public law agreement may also be entered into, however, in order to impose the clean-up on the owner of the real property in question.

4. Legal Recourse

How and under what preconditions an individual or entity may seek recourse against an administrative decision in dispute is stipulated in the Administrative Court Procedures Code *(Verwaltungsgerichtsordnung)*. The right of every individual to comprehensive and effective protection against illegal measures taken by public administration is derived from the rule of law principle. The special multi-tiered system of administrative jurisdiction grants particular importance to any party's ability to seek legal recourse. For this reason, Germany is often referred to as a State governed by the rule of legal proceedings.

Germany has a complicated, but generally reliable and effective public administration system which is subject to extensive control by the courts in public administration matters.

XVII. Public Procurement, Tenders

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1. Introduction

Public procurement means the procedure which is applicable to public authorities ("public parties") in the event they intend to obtain goods, services or works with a specific value. The relevant public authorities are, pursuant to EC Directive 2004/18/EC, any government, regional or local authority, body governed by public law, association formed by one or several of such authorities, or one or several of such bodies governed by public law.

The EC public procurement rules define the tender procedures which public authorities must comply with before awarding a contract to a tenderer. Public sector procurement must observe transparent, unrestricted procedures, which ensure fair competition among suppliers. On the EU level, public procurement policy seeks to create competitive, non-discriminatory public procurement markets.

Expertise in public procurement rules is most important for potential tenderers ("private parties"). Participation in procurement projects enables private parties to expand their business within the boundaries of the EU. The value of all public procurement activities in Germany comes to €250 billion each year. The promotion of public procurement in national markets has significantly increased cross-border competition and improved prices paid by public authorities.

2. Public Procurement Rules in Germany

The system of public procurements in Germany is divided in two categories. This system was substantially revised in 2016.

a. National Procurement

The procurement of construction works, purchase of goods and services with a total value of less than €5,225,000.00 (construction works) or €209,000.00 (goods and services) is reserved to national procurement rules. With regard to constructions works, public authorities have to comply with the conditions of the

VOB/A (VOB – Vergabe- und Vertragsordnung für Bauleistungen). Concerning the purchase of goods and services, the public authorities have to observe the regulations of the *VOL/A (VOL – Vergabe- und Vertragsordnung für Leistungen)*. Tenderers' rights to seek legal protection in the event of incorrect or illegal procurement procedures are very limited within the boundaries of a national procurement procedure.

b. EU-wide Procurement

As soon as the total value of the construction works procured by the public authority exceeds the amount of €5,225,000.00, the public authority is mandatorily obliged to initiate an EU-wide procurement process. With regard to construction works, the public authority has to comply with the conditions of the *VOB/A-EU*. As far as the purchase of goods and services with a total value of more than €209,000.00 is concerned, the public authority has to comply with the conditions of the *Vergabeverordnung (VgV)*. Both procurement procedures are governed by the Law Against Competition Restraints or *"Gesetz gegen Wettbewerbsbeschränkungen" (GWB)*. With regard to EU-wide procurement procedures, the *GWB* provides effective legal protection for tenderers who claim incorrect or illegal procurement procedures.

At the beginning of every public procurement on EU level, the public authority must publish its procurement request in the Official Journal of the European Community in order to enable especially foreign tenderers with legal domicile within the European Union to participate in the procurement process equal to national tenderers. The public authority can choose between the "open" procurement procedure and the "restricted" procurement procedure. Both procedures are meanwhile regarded as equal. Tenderers of an "open" procurement procedure are entitled to request the procurement documents and can hand in their tenders without any restriction. Tenderers of a restricted procurement procedure can participate in the first step, but will be selected by the public authority in the second step. The restricted procurement procedure entitles the public authority to restrict the number of tenderers to an exclusive circle.

Under exceptional circumstances, public authorities are entitled to initiate a "negotiation" round, which means that only a small number of tenderers will be invited to hand in their tenders, which will then be individually negotiated. For tasks of massive complexity, especially but not limited to Public Private Partnerships (PPP), a procedure called "competitive dialog" can be chosen by the public authority. The intention of this procedure is the development of a suitable solution by the public authority and tenderer by mutual dialog. Before the public authority awards the contract to the favorite tenderer, it is obligated to inform all competitors about the reasons why they will be rejected.

According to the regulations of the *GWB*, respective tenderers are entitled to seek legal review or remedy within a specific deadline by addressing an institution called procurement chamber *(Vergabekammer)*. During this process, the procurement procedure is suspended and every award of a contract by the public authority to the favored tenderer prior to the decision of the *Vergabekammer* is deemed invalid. In the event the tenderer seeking legal review or remedy should lose its case, he has the right to appeal to the next instance, which is the procurement senate *(Vergabesenat)* of the responsible court of appeal. These procedures are rather costly for tenderers, the expenses for the procedure before the *Vergabekammer* are a minimum of €2,500.00, the appeal to the court leads to additional and higher expenses because tenderers must be represented by legal counsel. In case a public authority awards a contract to a contractor without first having exercised any applicable public procurement procedure (de facto procurement), potential tenderers have the right to interfere and may seek legal review or remedy before the competent *Vergabekammer*.

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3. Private Parties as "Contracting Authorities"

Private parties fulfilling certain criteria are deemed "public authorities" if the private party was founded specifically to serve public interest, does not serve commercial tasks, and is subsidized by public funds. Therefore, a lot of joint ventures between public and private partners are regarded as public authorities with the consequence that they have to comply with the relevant public procurement procedure when they intend to conclude contracts with subcontractors. Private companies receiving government funding or grants are regularly required to observe public procurement rules as well.

XVIII. Energy Law

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1. Energy Policy and *Energiewende* in Germany

The status of Germany's energy law reflects the country's main political energy targets: the liberalization of the energy markets, nuclear phase-out, and the substitution of conventional power generation by renewable energies.

Today, Germany has one of most competitive and liquid energy markets in Europe, following a successful liberalization of the electricity and gas markets. By contrast, the original energy policy, stipulated in the Energy Industry Act of 1935 *(Energiewirtschaftsgesetz 1935 – EnWG 1935)*, was characterized by the supply of industrial and household customers in monopolistically closed areas of supply. Only under the influence of the European Union, this policy was radically reformed towards a liberal competitive opening of the markets for electricity and natural gas.

Germany is going to phase out nuclear power generation by the end of 2022. The first atomic power plants have already been decommissioned. Already in 2001, Germany decided to phase out nuclear energy. However, later the government pushed the scheduled decommissioning further in the future for economic reasons (*Laufzeitverlängerung* – lifetime extension). Following the atomic accident in Fukushima in 2011, the German legislator reversed itself again and decided to revoke this lifetime extension.

This decision has wide political support: after the incident in Japan, a large proportion of the German population feels threatened by nuclear power plants. In addition, there is widespread concern about the unresolved issue of the final disposal for nuclear waste.

Germany is a forerunner in expanding the use of renewable energies. Against the backdrop of the advancing global warming, Germany wants to give an international example of action with regard to climate protection. Following its decision to phase out nuclear generation, Germany strengthened its efforts to increase the share of renewable energy. It is Germany's official target to source

at least 40% to 45% of the electricity consumed in Germany from renewable energy by 2025. This percentage shall increase to at least 80% by 2050. All fossil fuels is to gradually be replaced by renewable energy, which is referred to as energy transition (*Energiewende*).

2. Historical Development

a. EU's First Legislative Package and Electricity and German Energy Industry Act of 1998 *(EnWG 1998)*

The European Union incorporated energy industries into the internal market in 1996 and 1998 by enacting the EC Directives on Common Rules for the Internal Market in Electricity and Natural Gas. National legislators were required to open their markets for electricity and natural gas gradually, applying the principle of non-discrimination for all market players.

This led to the Energy Industry Act of 1998 (*EnWG 1998)* focusing on the electricity sector and its amendment of 2003, focusing on the gas sector. The completely renewed *EnWG* opened the German energy markets for competition for the first time, abolishing exclusivity agreements in concession contracts and market demarcation agreements. Instead, it implemented a system of negotiated access in which the conditions for the network access were to be stipulated by the industry associations *(Verbändevereinbarungen)*. This self-regulatory approach did not have the desired effect on the gas and electricity markets. Overall, at this early stage of the liberalization, the incumbents were able to maintain their positions.

b. EU Acceleration Directives and Energy Industry Act of 2005 *(EnWG 2005)*

In 2003, the European Union modified the framework for the national legislation by enacting the so-called Acceleration Directives for electricity and natural gas. According to these directives, the Member States had established national regulatory authorities. Member states were required to give the authorities the power to regulate network charges. In addition, the acceleration directives foresaw the legal unbundling of vertically integrated undertakings.

These considerable changes of the EU law made a complete revision of the *EnWG 1998* necessary. The act was replaced by the *EnWG 2005*, in which Germany abolished the previous German system of negotiated network access. As hoped for, the liberalization in Germany picked up speed – on the energy wholesale markets as well as on the retail markets.

c. EU Third Energy Package and Energy Industry Act of 2011

In 2009, the European Commission enacted new directives and regulations for the energy sector in the so-called Third Energy Package. Under the Third Energy Package, the rules concerning the independence and neutrality of the network operators became stricter. In general, transmission operations needed to be carved-out from the other activities of vertically integrated undertakings (so-called ownership unbundling). Member states were allowed to establish a fiduciary model (independent system operator – ISO) or to maintain a strict legal, accounting, informational, organizational and personal unbundling (independent transmission operator – TSO) instead of an ownership unbundling, but only to the extent the transmission system already belonged to a vertically integrated undertaking on 3 September 2009.

To implement the Third Energy Package, Germany modified the Energy Industry Act in 2011 *(EnWG 2011)*.

d. *Energiewende* Legislation

The atomic catastrophe in Japan led to the Federal Government's nuclear moratorium of 14 March 2011. In the moratorium, it was provided that all German nuclear power plants shall be subject to a safety check. Furthermore, the oldest plants had to temporarily or permanently cease operations. In addition, Germany

revised its energy policy in general. Therefore, the Federal Government issued the so-called Energy Transition Resolution *(Energiewende-Beschlüsse*) on June 6, 2011. Only two months later, various energy-related acts where amended.

e. Renewable Energies Act *(EEG 2017)*

Since 1991, Germany has a permanent statutory scheme to foster renewables. In the year 2000, the Renewable Energies Act *(Erneuerbare-Energien-Gesetz – EEG)* entered into force. The Renewable Energies Act had the aim to make it easier for emerging technologies such as wind and solar energy to enter into the electricity market by granting a fixed feed-in tariff, preferred feed-in into the grid and an offtake guarantee.

The most recent amendment of the Renewables Energy Act occurred with the *EEG 2017*. With the 2017 modifications, the fixed statutory tariffs were generally replaced by tendering processes. In addition, the *EEG 2017* specifies concrete statutory targets (extension corridors) for the (annual) capacity additions of each technology (onshore and offshore wind, solar and biomass). The tender procedure shall foster cost efficiency and ensure that the targets are met, but not exceeded.

f. Proposal for a EU Winter Package

In November 2016, the European commission has published plans for a new legislative package focusing on the European climate and efficiency targets. The "Clean Energy for All Europeans" proposal (so-called Winter Package) covers, inter alia, energy efficiency, renewable energy, the design of the electricity market, security of electricity supply and governance rules for the Energy Union. The proposal is currently up for discussion.

3. Regulatory Framework for the Electricity and Gas Markets

a. Regulators

In general, the Federal Network Agency has the competence to regulate German network operators *(Bundesnetzagentur)*. However, in some federal states network operators with smaller grids, not exceeding 100,000 customers, are regulated by state regulation authorities *(Landesregulierungsbehörden)*. Currently, ten states have own regulators.

b. Network Charges

Network charges are supervised based on an incentive regulation. At the beginning of a regulatory period, a revenue cap and efficiency targets are defined. These are based on an assessment of the network operator's actual costs and its efficiency, determined by a benchmark method.

c. Access to the Wholesale Market

The German wholesale market for electricity and gas is open to all traders. No license is required for exchange trading or off-market trading. Imports and exports of electricity and gas do not require a governmental approval. However, German market participants have to register with the Federal Network Agency under the applicable market supervision provisions. The same applies to non-EU entities if they are not already registered in another member state.

d. Access to the Supply Market

End-consumers in Germany, including industry and households, can choose their supplier for electricity and gas. German and foreign companies, which want to supply household customers, need to notify formally the Federal Network Agency. Suppliers need to comply with their obligation to provide monitoring data to the Federal Network Agency.

e. Access to the Electricity Network

Access to the electricity network – consisting of four transmissions system and around 900 distribution networks – is organized according to a so-called "stamp model" *(Briefmarkenmodell)*: only end-consumers pay a network charge which covers all networks of higher voltage levels. Injecting electricity to the system is free of charge. Generators, consumers (or its suppliers) have to enter into a grid usage contract with the connection network operator. This contract gives them access to the complete German electricity network. In addition, generators and consumers (or their suppliers) need to sign a balancing group contract with a transmission system operator, because any take-off and feed-in requires the assignment to a balancing group.

The details of the grid access are set forth in the Electricity Network Charge Ordinance *(StromNEV)* and the Electricity Network Access Ordinance *(StromNZV)* as well as determinations *(Festlegungen)* by the *Bundesnetzagentur*.

f. Access to the Gas Network

To give shippers access to the gas transmission system, Germany has implemented a so-called "entry-exit model" or "two-contract model." Shippers need to buy capacity rights from the network operators for entry- and exit points. The capacity price does not depend on the transmission route or distance.

In general, shippers can freely combine entry and exit capacity within one market area. The 16 transmission systems in Germany have established two market areas for gases of both qualities (high and low calorific value). GASPOOL in Northern and Eastern Germany and NetConnect Germany (NCG) in Western and Southern Germany. Both market areas have a virtual trading point where gas can be sold. The ministry of economics has published plans to combine the markets areas NCG and Gaspool until April 2022.

Generally, shippers are required to keep injections and withdrawals within one market area balanced for every day. To record injections and withdrawals, the operators of the two market areas keep balancing groups. Charges for imbalances apply.

The principles for gas network access foreseen are expanded in the Gas Network Access Ordinance *(GasNZV)* and the Gas Network Charge Ordinance *(GasNEV)*. The details of the collaboration of the network operators are stipulated in the so-called Cooperation Agreements *(Kooperationsvereinbarung – KoV)*.

4. Framework for the Support of Renewables

a. Direct Marketing

Under the *EEG 2017*, operators of renewable energy plants generally have to sell the generated power to the market themselves, typically by contracting with a service provider. In addition to the proceeds received from the disposal of the electricity, the plant operator receives a market premium from the grid operator. The market premium is calculated based on the applicable tender award (see below) or the applicable tariff minus its technology specific monthly market value. Exemptions from mandatory direct marketing can apply for energy produced by small plants and compensation in case of an impossibility to market the energy directly.

b. Tender Process and Fixed Statutory Tariffs

In general, the support payments under the *EEG 2017* will be determined in a market-based tender scheme organized by the Federal Network Authority. The tender volume depends on the statutory targets for new capacity. Developers have to indicate with their bid the requested amount for the market premium (cent per kilowatt-hour of generated electricity, including the market value). The lowest bids are awarded. Only successful bidders can build renewable power plants that are eligible for financial support.

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Fixed statutory tariffs will remain, inter alia, for smaller plants, which do not exceed the capacity thresholds foreseen in the Renewable Energy Act for each technology.

c. Support Period and Grandfathering

Eligible renewable energy plants receive support payments for the energy generated during a period of 20 years after commissioning. Since the first *EEG 2000*, the incentives system for renewables has been modified regularly to adopt the financial support to the decreasing installation costs for renewable plants and the changing political priorities. However, these legal adjustments never affected existing plants. German constitutional law protects the rights of pre-existing plants in case of legal changes. Older plants in Germany still receive support according to the terms and conditions that were applicable at the time of their commissioning.

d. Settlement and Allocation Mechanism

The network operators are in charge of settlement of the financial support payments. The financial payment is made by the operator of the distribution network, to which the power plant is connected. The network operator also has to examine whether the conditions for financial support under the *EEG* are met.

The network operator passes the costs of the support payments on to the responsible transmission system operator. After an equalization of the cost between the four transmission system operators in order to smear regional differences, the costs are charged to the end-consumers that have to pay the *EEG* levy *(EEG-Umlage)* together with the network charges.

XIX. Environmental Law

Numerous changes to German environmental law have come into force over the last years: In 2012, a new Recycling and Waste Management Act *(Kreislaufwirtschaftsgesetz – KrWG)* came into force. In 2013, the IED Directive (Industrial Emissions Directive) was implemented in German law by amending the Federal Immission Control Act *(Bundes-Immissionsschutzgesetz – BImSchG)* as well as several Ordinances relative to the BImSchG. Furthermore, the RoHS II Directive was transposed into national law by enacting the Electrical and Electronic Substances Ordinance *(Elektro- und Elektronikgeräte-Stoff-Verordnung)*. The WEEE Directive was transposed into German law by amending the Electrical and Electronic Equipment Act *(ElektroG)* in 2015.

1. Introduction

In Germany, particularly from the beginning of the 1970's, exhaustive legislation has been adopted in the area of environmental law, inter alia, the Federal Immission Control Act, the Federal Nature Protection Act, the new version of the Water Resources Act, and the Recycling and Waste Management Act. Under this legislation, licenses and permits are the central instruments used to ensure compliance with environmental regulations. Moreover, many acts contain significant reporting and disclosure obligations in case environmental problems occur.

With the adoption of this legislation, the rise of international agreements and, in particular, the legislative activity on the EU level, the importance of environmental law in Germany grew steadily. The EU's continuous endeavors to harmonize and raise the environmental protection standards in the Member States have had a perceptible effect on German environmental law in recent years, although it is worth noting that this EU environmental legislation is tailored to a high degree by German influence. Consequently, among the 28 EU Member States, Germany is one of a handful with the strictest environmental, health and safety regulations and enforcement.

Having said this, however, even successful international efforts aiming at uniformity will not prevent the continued existence of national German environmental law with its particularities. Moreover, the Treaty on the Functioning of the European Union (formerly EC Treaty) itself enables Member States to enact, in certain instances, stricter unilateral measures in the field of environmental law.

It is essential to note that, in the German Constitution, environmental protection is acknowledged as a central aim and duty for federal and state legislative and administrative institutions to pursue. Offenses against the various environmental acts can be punished severely under the Criminal Code, as discussed below.

2. Legal Basis and Principles

Understanding of German environmental law implies knowledge of the relevant provisions of German Constitutional Law. Since 1994, environmental protection is explicitly anchored as an objective of the legislative and administrative institutions in Article 20a of the Federal Constitution and in most of the Constitutions of the States *(Länder)* as well. This devotion to environmental protection is binding on both the Federal legislation and the administrative dealings of the Federal public authorities, as well as on the implementation and execution of this aim by the *Länder*.

Federal law takes precedence over State law. The legislative competence of the Federation extends, among others, to environmental protection tasks of waste disposal, the preservation of clean air, the combating of noise pollution (emissions control), nature protection, and the management of water resources. Within these spheres, however, there remains scope for legislation on the part of the individual *Länder*, as long as and to the extent to which the Federation itself has not made use of its right to legislate. In some areas, the *Länder* have also the possibility to adopt regulations that deviate from federal environmental law.

3. Hazardous Substances

The Law on Hazardous Substances primarily encompasses the protection of the environment from hazards that may emanate from chemicals. The core of the relevant legislation is the Chemicals Act *(Chemikaliengesetz)* of 1980, as amended in 2013. The Chemicals Act, amongst others, contains provisions on duties of notification and testing of hazardous substances defined as such in the Chemicals Act.

The Act is implemented by a number of statutory ordinances, inter alia, the Chemicals Prohibition Ordinance *(Chemikalienverbotsverordnung)* and the Hazardous Substances Ordinance *(Gefahrstoffverordnung)*. As regards the Chemicals Prohibition Ordinance, it contains regulations that deal with prohibitions on substances and the restriction of their introduction into circulation.

Anyone who, as a manufacturer or importer, places on the German market a hazardous substance or a preparation containing at least one dangerous characteristic must package and label the substance/preparation in accordance with the provisions of the Hazardous Substances Ordinance. In most cases, the degree of hazard is evident from the legal categorization that follows from the numerous EU Directives adopted in this field. The Hazardous Substances Ordinance also contains prohibitions on both manufacture and use, as well as numerous duties of protection in favor of employees in the handling of hazardous substances. It has been amended in 2010 because of the EU´s new chemicals control regime (see below). Pesticides and biocides are regulated by specific pieces of legislation.

At the European level, the EU's chemicals control regime, the Regulation on REACH (Registration, Evaluation and Authorization of Chemical Substances), entered into force on June 1, 2007. This Regulation, having direct application in all EU Member States with no national transposition act necessary, replaced some 40 EU Directives and Regulations on chemicals. One of the main motives for the reform was that the distinction between so-called "new" and "existing"

chemicals did not guarantee an efficient assessment (i.e., testing) and control of the latter. This distinction is based on the cut-off date of September 18, 1981. All chemicals that were placed on the EU market before 1981 were perceived as "existing" chemicals, on which only insufficient information has been available. Only "new" chemicals, i.e., those placed on the EU market after September 18, 1981, were stringently regulated in the past. Such incoherent legislation constantly frustrated EU regulators, and with the help of "green" pressure groups and against significant opposition from industry associations, the onerous and cost-intensive REACH system has been introduced. As a basic rule, all chemical substances manufactured in or imported into the EU in volumes of at least 1 metric ton must be registered with the newly founded European Chemicals Agency (ECHA), located in Helsinki, before they can be placed on the EU market. Depending on their hazard assessment under the evaluation procedure, substances can also be made subject to authorization requirements and, as a final safety net, to restrictive measures. It is important to note that the system not only affects the chemical industry but virtually any downstream undertaking that uses chemicals subject to REACH in its products.

4. Waste Disposal

Originally, the disposal of waste in the Federal Republic took place predominantly on the basis of municipal law. This system proved to be insufficient, however, because of the increasing quantities of industrial and household refuse and the considerable concentration of pollutants. Hence, competing legislative competence was granted to the Federation in 1972, which adopted a Waste Disposal Act in the same year. Through several amendments, its provisions were adjusted to the developments in the sector. The relevant legislation in force today is the Recycling and Waste Management Act *(Kreislaufwirtschaftsgesetz)*, which aligned German waste law with Directive (EC) 2008/98. EU provisions are becoming more and more important in this sector. In addition, some special kinds of waste, e.g., biological waste, are now governed by special pieces of legislation.

The Recycling and Waste Management Act defines minimum quantities of recycling of household and certain other wastes, envisages a new and more refined separation of waste and tries to strike a balance between the role of local municipalities and private enterprises in the waste disposal business. A crucial element of the new Recycling and Waste Management Act is the hierarchy of waste, which provides for the graduation of avoiding, recirculation, recycling, energy recovery, and finally the disposal of waste. The option which has the least implications on the environment is preferential. The Recycling and Waste Management Act brought fundamental changes in various respects to the German Law on Waste Disposal.

5. Electrical and Electronic Equipment (EEE)

In 2003, the EU adopted two Directives which deal with the hazardous impacts on the environment of old electrical and electronic appliances: a Directive on Waste from Electrical and Electronic Equipment (WEEE) and a Directive on the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS). While the former deals with the collection and the treatment of old appliances, the latter introduces a phasing-out of certain hazardous substances, such as lead, mercury and cadmium, PBB and PBDE. Both Directives were transposed into German law by the Electrical and Electronic Equipment Act in 2005, as amended in 2010, imposing the principle of producer responsibility on manufacturers and importers in Germany. Noncompliance with these fundamental pieces of legislation will lead to significant import and marketing bans.

Both the WEEE Directive and the RoHS Directive were amended recently. While the RoHS II Directive already entered into force in January 2013, the amended WEEE Directive entered into force in August 2013. Germany implemented the RoHS II Directive by adopting a new ordinance, called Electrical and Electronic Substances Ordinance *(Elektro- und Elektronikgeräte-Stoff-Verordnung)*.

The most important amendments are as follows: The scope of the Electrical and Electronic Equipment Act will be extended stepwise. From August 2018, all electrical and electronic equipment will be covered by the Electrical and Electronic Equipment Act, unless an explicit exception is made. Furthermore, most distributors will be obliged to provide for the collection of very small electrical and electronic equipment free of charge to end users and with no obligation to buy electric or electronic equipment. Finally, the collection rates will be raised stepwise.

6. Water Protection

As far as water protection is concerned, Germany is one of the strictest enforcing EU countries, possibly due to emotional historic ties to its dominant rivers such as the Rhine. The Federal Constitution, in its Article 72, gives the Federation competence to issue legislation in the field of water resources management. The Water Resources Act *(Wasserhaushaltsgesetz)* was adopted in 1957 and entered into force in 1960. Over the years, the text has been amended several times, particularly in order to implement forthcoming EU provisions. The latest reform entered into force on March 1, 2010. It provides for uniform rules in all Federal States, but nevertheless allows for departures in certain areas. The Water Resources Act is based upon the principle of water management. In accordance therewith, it is the aim of the Act to protect bodies of water through sustainable management as a component part of the balance of nature, a basis of human life, a biotope for plants and animals and as a public good. In order to achieve these aims, the Water Resources Act subjects bodies of water to a public law system regulating use, e.g., in relation to the use of groundwater, requiring for the most part a sovereign permission.

7. Nature Protection and Landscape Conservation

The aim of German legislation in the field of nature protection and landscape conservation is no longer an economic one. Previously, the public goods "nature" and "landscapes" had to be sensibly utilized in economic terms so that they remain available on a permanent basis in the future. Since the latest amendment of the Federal Nature Protection Act *(Bundesnaturschutzgesetz)*, of 2009, however, which entered into force on March 1, 2010, nature and the landscape are protected due to their inherent value and because they are the basis of human life and human health. It is no longer a framework act, but provides for uniform rules in the whole of Germany. Nevertheless, in some areas, such as landscape plans, the *Länder* retain the competence to pass laws. In addition, other requirements of Nature Protection Law contained in statutory ordinances issued by the *Länder* and – in some of them – landscape plans and "green order plans" may become legally binding, transposing EU legislation summarized under the term "Natura 2000."

The Federal Nature Protection Act stipulates special requirements regarding the protection of Natura 2000 areas and of protected species. These provisions have to be taken into account in approval procedures or planning processes. With regard to Natura 2000 areas, projects may not be approved if the project were to cause significant effects in the protected areas. Only under strict conditions – e.g., imperative reasons of overriding public interest – derogations from those requirements may be granted. If a project endangers protected species by e.g., killing or catching them, significantly disturbing them or damaging their breeding sites and resting places, it violates the special provisions on the protection of species and may not be approved, either. Due to much stricter requirements for the protection of nature and wildlife by German jurisprudence, both brownfield and greenfield developments have become significantly more challenging.

There are also several additional special regulations as the legal basis for special Nature Protection Law, such as the Federal Forests Act *(Bundeswaldgesetz)* and the Animal Protection Act *(Tierschutzgesetz)*.

8. Immission Control

Protection against hazardous immissions has a long legal tradition in Germany. Construction and alteration of particular hazardous installations have been put under a licensing requirement quite early. Today, the provisions concerned are contained in the Federal Immission Control Act *(Bundes-Immissionsschutzgesetz)*. This Act and its numerous implementation ordinances, which have been amended several times, particularly in order to implement EU provisions, have a far-reaching scope of application. They encompass all legal provisions that directly or indirectly serve the protection of human beings and their material goods from "incalculable" effects such as air pollution, noise, heat, the effects of light, and vibrations. Consequently, competences of the *Länder* have decreased. They are, however, granted competence to issue statutory ordinances, such as anti-smog ordinances. Regulations concerning emissions control are also contained in numerous other statutes, such as the Air Traffic Act. Recently, the Directive 2010/75/EC on industrial emissions was transposed into German law. Several amendments to the Federal Immission Control Act and its numerous ordinances were made in order to ensure compliance of national law with the provisions made in the Industrial Emissions Directive. The amendments entered into force in April 2013, although transitional periods for existing plants are provided. Among others, the amended Federal Immission Control Act brings new monitoring requirements and the importance of the best available techniques.

As regards noise emissions in particular, it is worth noting that there are no uniform noise protection standards in Germany. The existing systems of rules only cover partial areas, e.g., the Fifteenth BImSchV (Construction Machinery Noise (Implementation) Ordinance) or the Aircraft Noise Protection Act. In the remaining cases, it is up to case law to judge what level of noise nuisance can reasonably be tolerated.

The concept of emissions trading aims at reducing greenhouse gas emissions on a global scale is agreed internationally in the UN Framework Convention on Climate Change and the Kyoto Protocol. Moreover, at EU level, provisions have been adopted, notably the European Union Emissions Trading Scheme for trading allowances to cover the emissions of greenhouse gases from permitted installations.

In Germany, the required implementation of this scheme is provided for in the Greenhouse Gas Emissions Trading Act *(Treibhausgas-Emissionshandelsgesetz)*, adopted in 2004. It includes regulations of the allocation procedure, issuing, surrender and validity of licenses, their trading and penalties, as well as provisions concerning details of the permit, verification, and monitoring of greenhouse gas emissions. The Act was accompanied by an Act on the National Allocation Plan for the allocation period of 2005 – 2007 *(Gesetz über den nationalen Zuteilungsplan für Treibhausgas-Emissionsberechtigungen)*, defining the total amount of allocated emissions rights and specifying the allocation of emissions rights to individual installations. A second plan for the years 2008-2012 was passed in 2006. The last amendment of the Greenhouse Gas Emissions Trading Act took place in 2011. The current version of the Act sets out rules about Emission Trading from 2013 onwards. It is accompanied by the Allocation Regulation 2020 *(Zuteilungsverordnung 2020)*.

9. Environmental Criminal Law

Environmental criminal law and regulatory offenses law in Germany are based on the consideration that criminal law sanctions must be imposed in order to conserve ecologically valuable objects of legal protection and for the enforcement of environmental administrative law. In 1980, the Federal Government integrated the offenses scattered in various administrative statutes into §§ 324-330d of the Criminal Code *(Strafgesetzbuch – StGB)*.

The aim of the inclusion of these provisions was to strengthen environmental awareness and to combat criminal offenses against the environment more effectively.

It is important to note that all environmental offenses of the StGB can be committed both with intent and through negligence. Conduct that breaches a duty of care can give rise to criminal liability, even though the offender does not foresee the fulfillment of the elements of the offense. This leads to considerable risks of criminal liability, especially in a complicated area such as environmental law.

The environmental offenses themselves have been strengthened by the Second Act to Combat Environmental Crimes *(Zweites Umweltkriminalitätsgesetz)*, providing a new structuring of the elements of an offense, the frequent increase of penalties or measure of sentence and the creation of new offenses, e.g., the criminal offense of soil contamination, § 324a StGB. Criminal offenses against the environment can be sentenced with pecuniary criminal penalties or prison terms of up to three or up to five years, depending on the offense in question and on the degree of intent or negligence of the offender. The imposition of prison terms is extremely rare in practice, however. Under § 330 StGB, penalties will be increased if the – intentional – offense in question constitutes a "particularly serious case of a criminal environmental offense."

The provision contains a list of cases, which "usually" lead to the presumption of a "particularly serious case" of an intentional offense, punishable by prison terms ranging from six months up to ten years. The pollution of bodies of water (§ 324 StGB), soil contamination (§ 324a StGB), air pollution (§ 325 StGB), etc., will be sentenced by prison terms of up to five years or a pecuniary fine if the environmental offense was committed with intent, and of up to three years or a pecuniary fine if the offense was committed with negligence.

As far as regulatory offenses law is concerned, the Second Act to Combat Environmental Crimes brought the extension of the responsibility under administrative fine law and of the possibilities for confiscation or product seizures by amending the Regulatory Offenses Act *(Ordnungswidrigkeitengesetz – OWiG)*. Moreover, polluting plants may be shut down by authorities, and hazardous products can be banned from the market. Administrative fines that punish regulatory offenses can reach significant levels. The highest fines for intentionally committing a criminal offense in connection with § 30 OWiG, can reach €10 million, for an intentional breach of the duty of supervision, as set out in § 130 OWiG, the highest fine can reach €1 million.

Moreover, at EU level, the Council has issued a Directive on the protection of the environment through criminal law (2008/99/EC) with the goal of setting out minimum requirements relating to criminal law in EU Member States to ensure better protection of the environment. The Directive contains a number of offenses that must be considered criminal offenses by all Member States. By this Directive, the Commission pays tribute to the annulment of a preceding framework decision on environmental crime by the European Court of Justice. Although the Court acknowledged that criminal law is, in general, not contained in the EU list of competences, it further ruled that this does not prevent the Community from ensuring that EU Member States enforce EU environmental law through effective and proportionate criminal sanctions.

In Germany, an Act was adopted in 2011 to fulfill the required implementation of the Directive on the protection of the environment through criminal law (Forty-fifth Law Amending Criminal Law). By this Act, various provisions of the Criminal Code – including the criminal offense of improper handling of waste, § 326 StGB – have been amended.

10. Environmental Liability

Historically, EU Member States have had their own environmental liability systems, which have developed from a historically fault-based to a stricter, non-fault-based approach when dealing with liability for environmental pollution. At EU level, a compromise as regards an EU-wide uniform liability system was

reached in 2004, with the adoption of a Directive on this subject. The Environmental Liability Directive has a wide scope of application. It is designed to apply to contamination of water and biodiversity and to soil pollution.

Germany has issued a new law, the Environmental Damages Act *(Umweltschadensgesetz)*, in order to implement the new provisions of the Environmental Liability Directive into German law. In addition, the Federal Nature Protection Act and the Water Resources Act have been amended. The Environmental Damages Act is based on the "polluter pays principle," which requires the polluter and not the public to pay for environmental damage caused. Under the Act, operators who carry out potentially hazardous activities, including the release of heavy metals into water or the air, installations producing hazardous chemicals, landfill sites, and incineration plants, are held accountable to cover the cost of preventing or remedying damage that has occurred as a result of these activities. Public authorities have to ensure that the polluters will undertake themselves, or will finance, the necessary preventive or remedial measures. A complaint can be lodged only with a competent governmental authority, which will then decide whether there is a case to investigate or not.

11. Soil Contamination Issues and Remediation Obligations

The Federal Soil Protection Act *(Bundes-Bodenschutzgesetz)* and The Federal Soil Protection Ordinance provide uniform national requirements for soil and groundwater protection and remediation of soil and groundwater contamination. If an owner discovers contamination of soil or groundwater, he can be forced by law to remediate the contamination, even if there is no binding order to do so issued by the public authorities. In certain circumstances, there is an obligation to inform the authorities if pollution occurs.

The Federal Soil Protection Act defines which parties are responsible for remediation. This includes the polluter who has personally and directly caused the damage (even if he/she has acted without negligence or intent). Under certain circumstances, the owner or lessee of a site may also be responsible. The same applies to the shareholders of a legal entity which owns a contaminated site, and even the former owner of a site (e.g., if he/she was aware, or should have been aware, of the contamination). If it turns out that several parties are responsible, it remains at the discretion of the authorities which party or parties will be held responsible to carry out the remediation.

In the event that the authorities require one of several responsible parties to remove the contamination, that party may have a claim for full or partial compensation against the other parties. For investors, it is particularly important to note that the statutory compensation claims can be contractually excluded between the contract parties, and liability for contamination can be regulated between these parties by means of provisions in sale and purchase agreements dealing with environmental issues.

To ensure reasonable protection against liability risks with regard to soil contamination, due diligence should include inquiries with the Cadastral Register of Contaminated Sites, as well as inquiries with regard to soil protection charge notices. The Cadastral Register of Contaminated Sites contains official information on known or suspected contamination issues, which is of significant relevance to purchasers potentially exposed to environmental claims who have not obtained contractual indemnification from the seller.

Useful links:

- www.bmu.de
- www.umweltbundesamt.de www.baua.de
- www.imgb.de
- www.ec.europa.eu/dgs/environment/index_en.htm
- www.echa.europa.eu
- www.efsa.europa.eu

XX. Real Property, Purchase and Use by Foreign Investors

1. Construction and Planning

a. Construction Agreements and Related Contracts

Construction, planning, and project development agreements concerning real property are primarily subject to the general provisions of the German Civil Code *(BGB)*, in particular those concerning the "Production of a Work" (Secs. 631 et seqq. *BGB*) and the provisions concerning General Terms and Conditions (Secs. 305 et seqq. *BGB*) in case standard clauses are used for the respective contract. German law provides contracting parties with several types of contracts, mostly depending on the intent of the parties and the scope of the constructing project.

Building Contracts

Building contracts *(Bauverträge or Bauwerksverträge)* are contracts entered into by the builder *(Bauherr)* and the contractor *(Auftragnehmer)*. On the one hand, the main content of a building contract is the performance of certain construction work free of faults in time and in budget by the contractor. On the other hand, it is the payment of the agreed compensation by the builder to the contractor.

With regard to the compensation to be paid, distinction is made between unit-price contracts *(Einheitspreisverträge)* and lump-sum contracts *(Pauschalverträge)*. In the scope of a unit-price contract, the final compensation has to be paid only for the effectively rendered amounts and mass of each single performance, determined by the parties by means of a common measurement after completion of the works. With regard to lump-sum contracts, a fixed compensation has to be paid for a performance exclusively specified in the contract. Such specification of performances can be made by describing the single performances to be rendered by the contractor or by describing the general aim of the performances, e.g., erection of an office building with 5,000 square meters, air conditioning, and elevators, etc.

Building contracts are, especially with regard to bigger construction projects, regularly extended to a general contractor agreement *(Generalunternehmervertrag)*. Thereby the contractor undertakes vis-a-vis the builder to perform all necessary crafts (often by means of commissioning subcontractors) in order to erect a turnkey building project. The advantage of a general contractor agreement is that the builder only needs to contract with one party and that there is no need to contract with several companies for every component of the building process.

If the contractor also renders the planning, the contract is called engineering procurement construction contract (EPC contract, *Generalübernehmervertrag)*.

The conclusion of a building contract does not require a specific form under German law. Even an oral agreement between the parties would be valid. Often, the parties decide to incorporate the Procurement Rules Regarding Construction (see also Chapter VII above) in their contract *(Vergabe- und Vertragsordnung von Bauleistungen – VOB)*, i.e., conditions of contract relating to the execution of construction work or shorter the VOB Part B. The VOB contains e.g., proven regulations on price alterations and supplemental claims, warranty, securities, approval of works, etc. Furthermore, parties often agree to incorporate the FIDIC Rules when it comes to cross-border construction contracts. The FIDIC Rules contain also standard provisions for construction contracts.

Architectural Contracts

Architectural services are generally provided within a contract to produce a work *(Werkvertrag)*, governed by Secs. 631 et seqq. *BGB*. The contracting parties are the builder and the architect. Within a contract for architectural services, the architect is obliged to achieve a certain result, which means in particular licensable planning and a successful building inspection.

In return, the builder has to pay the agreed compensation. The compensation to be paid is determined by the mandatory "Fee scale for architects and engineers" *(Honorarordnung für Architekten und Ingenieure – HOAI)*. The *HOAI* determines not only the fees for building planning, but also the fees for engineering performances such as planning of structural framework and planning of technical

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building equipment. The *HOAI* determines a minimum and maximum fee scale for the different architectural and engineering services, which may not be fallen below or exceeded respectively by agreement of the parties.

The German Civil Code does not require architectural contracts to be in written form. A compensation for the services rendered by the architect commissioned by the builder has also to be paid without a written contract. A written contract is highly recommended, however. Without a written contract, the architect is only entitled to the minimum fee determined by the *HOAI*. The builder needs a written contract to prove the architect's scope of work in case of defects of the building.

Project Management Contracts

Project Management Contracts, so-called *"Projektsteuerungsverträge"*, are concluded to handle and organize complex building operations such as schools, hospitals or shopping centers. The contracting parties are the builder and the project manager, whereby the project manager often acts as representative of the builder. The obligation of the project manager is a combination of controlling and organizing duties. Due to the services of the project manager, in essence, the completion of the construction in time, in budget, and without defects should be safeguarded.

The legal nature of a project management contract can be both: a contract of mere services or also a contract to produce a work. It depends on the single case, the intention of the negotiating parties and the wording of the contract. Therefore, and since the *HOAI* is not applicable to project management contracts, it is important to exactly define the scope of services to be rendered by the project manager by means of written contract. Typical services to be rendered by the project manager are project organization, documentation, schedule planning and control, cost planning and control, finance planning, quality planning, planning requirements, and the control of competition and contract award.

b. Planning and Building Law, City Development Contracts

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The constitutional freedom to build is subject to certain statutory provisions. Urban development planning is mainly governed by federal laws. On a regional and local basis, the use of land is governed by local zoning and building plans.

In transactions involving real property, it is essential to check the structure as well as the current use of any buildings on the property with regard to both the relevant building permits as well as building and zoning plans. Buildings may only be used in compliance with the building permit and any change of use may depend on the latest building and zoning plans. For details on issues of soil contamination and remediation obligations, see section on Environmental Law below.

Planning and Building Law

With respect to local building regulations, two types of building areas exist – land which is subject to a zoning and building plan *(Bebauungsplan)* and land which is not regulated by such a plan. In urban areas, which are not subject to a detailed building and zoning plan, the size and type of the use of buildings must fit in with the neighborhood. Building projects in areas governed by a building and zoning plan are qualified for a building permit if they comply with the provisions of the relevant plan. The municipal building authority is obligated to grant a building permit if the statutory conditions of the plan are met.

Building and zoning plans are developed in a procedure with public participation. In the course of such public participation, everyone is entitled to comment on and object to the plan. After coming into effect of a building and zoning plan, the plan can be challenged to the higher administrative court.

The Federal German Building Act *(Baugesetzbuch – BauGB)* provides two different types of building and zoning plans. Other than a standard plan, the project-related zoning plan *(Vorhabenbezogener Bebauungsplan)* deals with a

specified project and can be customized for the benefit of this project. Typically, this kind of plan is drafted on behalf of an investor and at the investor's expense.

Such a bespoke zoning plan provides the upside of reflecting exactly the investor's objective; the downside is that the investor needs to commit himself contractually to materialize the plan and erect the relevant project.

City Development Contracts

According to the Federal German Building Act, urban development may be governed by city development contracts *(Städtebauliche Verträge)*. Subject matter of such contracts may be any site development, the cost sharing with regard to urban development measures, the implementation of nature conversation measures, and nearly any other purpose concerning urban development in a wide sense.

2. Development, Transaction and Asset Management

a. Real Property Acquisition

Land Register

Statutory German law ownership provides in Sec. 903 of the German Civil Code *(Bürgerliches Gesetzbuch – BGB)* for an absolute ownership of a property. The property is registered in the land registry *(Grundbuch)*, which is kept with the respective local court *(Amtsgericht)*, in which the property is located. The land registry contains three different sections, which in

- Section I lists the owners of the property and the kind of property transfer (e.g., purchase, heritage),
- Section II lists all relevant conditions, covenants, and restrictions, except mortgages *(Hypotheken)* and land charges *(Grundschulden)*,
- Section III lists all mortgages and land charges.

The land registry regime is strictly ruled by the principle of priority *(Prioritätsprinzip)* pursuant to which the rights of higher priority prevail over rights of lower priority. Pursuant to the Land Register Code *(Grundbuchordnung – GBO)*, the order of priority depends on the date of the respective registration.

Pursuant to Sec. 892 *BGB*, one can assume that the registrations in Sections I to III in the land registry are correct. This public reliance *(öffentlicher Glaube)* provides a party registered in the land registry as owner or mortgagee with comprehensive protection against any other party. Accordingly, the land registry is the most important document for real property transactions. The public reliance, however, only applies to the Sections I to III of the land registry. Any other information must be gathered from other registers, e.g., the cadastral map *(Liegenschaftskataster)*, the register of contaminated sites *(Altlastenkataster)*, and the register of public land charges *(Baulastenverzeichnis)*.

A property also contains the fixtures *(wesentliche Bestandteile)* pursuant to Sec. 94 *BGB*. Fixtures are such items, which are permanently connected to the land. They are acquired automatically with the property, whereas the fittings in accordance with Sec. 97 *BGB* are movable items, which only serve the purpose of the property. Nonetheless, there is a statutory presumption that the fittings are also included in a sale. Neither the fixtures nor the fittings are registered in the land registry, which would make the land registry impracticable due to regular changes.

Based on this principle, a purchaser does not acquire ownership with the notarization of the purchase contract, which is mandatory under statutory German law, but with the registration as owner in Section I of the land registry. The purchaser, however, is regularly protected between notarization and registration by a priority notice of conveyance *(Eigentumsverschaffungsvormerkung)*. Such priority notice protects the transfer of ownership of the purchaser vis-á-vis any other party.

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Asset Deal/Share Deal – Real Estate Transfer Tax

As already indicated, the acquisition of a property requires notarization pursuant to Sec. 311b *BGB*. With notarization of a property purchase contract, the purchaser is obliged to pay real estate transfer tax *(Grunderwerbsteuer – RETT)*. The RETT is a state tax *(Landessteuer)*, which varies from state to state. In order to avoid the payment of RETT, however, it is possible to acquire not the property as such (= asset deal), but the majority of shares in the property-owning company (so-called RETT Blocker). In order to avoid RETT, however, the acquiring company can only acquire 94.9% or less of the shares in the property-owning company and the remaining 5.1% of shares in the property-owning company must be acquired by an independent third party and held by such party for at least 5 years to avoid RETT. The remaining 5.1% usually are "secured" by way of "call" and "put options" agreed on between the acquiring company and the independent third company.

Another benefit, which can be generated by way of a share deal is a different valuation basis *(Bemessungsgrundlage)* for tax purposes. In case of an Asset Deal, the valuation basis is regularly the purchase price agreed upon in the purchase agreement. In case of a share deal, the valuation basis is the value of the property in accordance with the German Valuation Tax Act *(Bewertungsgesetz)*. The average difference between the different principles is 30%.

Hence, the RETT Blocker in particular makes sense in high volume transactions, in which the RETT and possible valuation savings are so significant, in order to accept the higher costs and risks of a Share Deal. This, in particular, applies since the tax authorities critically review the RETT Blocker constructions and the purchaser generally acquires all assets and liabilities of the target company. Therefore, the transactions costs for a share deal are significantly higher (e.g., full corporate legal due diligence of a company rather than property due diligence, involvement of accountants for accounting questions, and purchase price consideration, etc.). It needs to be carefully reviewed, whether or not a share deal makes commercially sense, taking into account the tax and commercial risks connected therewith.

Encumbrances

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A property can be encumbered with various rights of other parties. Such rights, which, in general, are registered in Section II of the land registry, are, inter alia, priority notice of conveyance *(Eigentumsverschaffungsvormerkung)*, hereditary building rights *(Erbbaurechte)*, easements *(Grunddienstbarkeiten)*, rights in rem for the usufruct *(Nießbrauchsrechte)*, restricted personal easements *(beschränkt persönliche Dienstbarkeiten)*, pre-emptive rights *(Vorkaufsrechte)*, or ground rents *(Reallasten)*. Other rights, which are registered in Section III of the land registry, are mortgages and land charges. Encumbrances, which are not registered in the land registry, are public land charges *(Baulasten)*, which are registered in the register of public land charges *(Baulastenverzeichnis)*. In the register of public land charges, all restrictions on the property under public law are registered, such as rights of access, rights to pass water and sewage pipes.

All of such encumbrances may limit the value of property. Therefore, it is advisable to – at least – undertake a diligent review of all property-related registers prior to the notarization of a property purchase agreement. Alternatively, it is advisable that the property purchase agreement provides for respective guarantees by the seller.

b. Lease Agreements

Lease agreements are the subject matter of a number of sophisticated and partly quite unusual legal rules in Germany. As leases are always the commercial essence of a real estate investment, a thorough and comprehensive handling of the respective issues is of particular relevance.

Written Form Requirement

Leases in Germany with a duration of more than one year must be in writing. This requirement is very important for commercial leases (less for residential), as non-fulfillment has the consequence that the commercial lease as such remains valid, but not the agreed duration. Instead, the commercial lease can be

terminated at any time with the statutory notice period, i.e., (only) six months by the calendar quarter.

This issue would still not be a major problem, if there were not a vast body of extremely complicated jurisprudence relating to the details of the written form requirement. Ultimately based on very old jurisprudence of the German Federal Court of Justice, the courts have developed a sophisticated system essentially demanding that all relevant elements of information concerning the lease must be contained in a fully comprehensive set of bundled written documents, which must be firmly connected. The consequence of this complicated jurisprudence is the fact that an unexpectedly high number of commercial leases does not fulfill the written form requirement as interpreted by the courts. This has obvious consequences for the funding of the respective real estate, which is usually based on valid long-term leases. It is, therefore, extremely important to always deal with this issue in a very careful and detailed manner.

Tenant Easements

Over the recent years, there has been a steadily increasing demand by commercially strong tenants that landlords should grant a particular "in rem" protection of the tenants' right to use the rented property. Such protection is demanded in the form of a tenant easement *(Mieterdienstbarkeit)* to be registered in the German real property register. As this registration has to have priority before land charges in favor of the financing banks to be effective in favor of the tenant, the respective demand necessarily leads to corresponding discussions with the banks.

In this context, the Association of German Pfandbrief Banks *(Verband Deutscher Pfandbriefbanken – VdP)* plays an important role. The *VdP* has developed specific guidelines as to how tenant easements should be worded in order to be acceptable for banks. Although these guidelines are developed by the *VdP* and do, therefore, not have any legally binding nature, it has become a very popular demand by more or less all German banks that tenant easements must be "*VdP*-compliant."

Further Specialties Regarding Leases in Germany

There are a number of further important legal specialties concerning leases in Germany, of which a real estate investor should be aware. Inter alia, it is important to know that leases for multiple use fall under the category of standard terms and conditions (*Allgemeine Geschäftsbedingungen,* general trade terms). General trade terms are governed by special statutory rules (general trade term rules). The adherence to such rules can be controlled by the courts. This means that it is important with a view to the validity of every commercial standard lease that the lease is drafted under adherence to the respective statutory rules as well as to the connected jurisprudence.

There are also many statutory rules in Germany on technical requirements for buildings having an impact, e.g., on the right of the landlord to impose service charges onto tenants. Also insofar as with a view to many other issues connected with leases, thorough and comprehensive drafting work is, therefore, of essential importance for the commercial success of a real estate investment.

c. Project Development

Project development of real estate can in principle relate to all types of possible use, such as retail, office, hotel, logistics, health care, or others. A project developer faces similar practical and legal problems in all types of project development. Once a developer has identified a suitable real property for his project, he has (i) to secure the acquisition of such real property, (ii) to obtain a building permit, (iii) to find and to legally bind users, (iv) to enter into construction contracts, and (v) to finance and to look for disposal of the developed property. All these different phases of a project development need to be linked to each other and be inter-related in order to make a project development successful. The main elements to be looked at for a successful project development can be summarized as follows:

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Securing of Development Property

If the project developer is not the owner of the real property on which he wants to develop his project, he needs to enter into an agreement with the actual owner of such a property allowing him to carry out the necessary measures for the project development. In principle, two alternatives exist in this regard: either the project developer acquires full ownership of the development property or at least an option to acquire such full ownership, which both makes it necessary to notarize the respective agreement and which trigger significant cost already at this early stage of the project development; or, at least for a certain initial phase of the development, the project developer takes the risk to only enter into a non-binding agreement by which the owner of the property allows the developer to carry out the initial measures for the development.

Obtaining of Building Permit

On a parallel basis, the developer needs to first analyze the Public Building Law situation of the development property. In most cases, it is necessary in a second step to either look for a change of the relevant Public Planning Law if that is not suitable for the envisaged development or at least to obtain a building permit on the basis of the already existing Public Planning Law. In this regard, it is in any event required to retain architects on the basis of a suitable contract with such architects who prepare the necessary planning and drawings for the building permit application.

Contracts with Users of the Development Property

If the property to be developed is still used by third parties, the developer needs to reach an agreement with them to vacate the property in order to allow the development to be carried through. In general, there is no valid legal claim for the developer to request the vacating, so it depends on his negotiation skills to reach such agreement.

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For the commercial success of a development it is even more important to find attractive new users since the relevant lease agreements to be entered into with them form the commercial basis for a potential investor to acquire the completed development. It is important to enter into binding lease agreements with such future users already at an early stage of the development. At the same time, this may trigger the necessity for the developer to agree on some flexibility as regards the exact description of the leased premises to be delivered and as regards the possible handover date to the tenant. In particular, these elements are generally not sufficiently defined at the rather early stage of the development when it is advisable to enter already into a binding agreement with the main tenants.

Construction Contracts

Apart from the purchase price for the development property to be acquired, the most significant cost driver for a project development is the cost of construction. That is why the relevant construction contracts are only bindingly entered into by the developer once he has obtained the relevant building permits and a significant number of tenants have signed binding lease agreements.

Financing and Disposal of the Project

A significant number of project developers have no strong equity basis. Accordingly, it is quite difficult for them to obtain full bank financing of the project development. That is why it has become more and more common to enter into forward funding deals. Institutional investors who want to invest their equity already at a quite early stage of a project development in order to secure the acquisition thereof definitively, are often willing to agree on an acquisition contract by which the payment of portions of the purchase price becomes due in different stages depending on the completion of predefined elements of the full project development. Such forward funding deal allows the developer to refrain from full bank financing. The developer has, however, to pay interest and grant security to the investor at similar conditions as under normal bank financing.

The chances of the project developer to find an investor willing to enter into such forward funding deal significantly increase if the developer has done his homework properly. This requires, apart from the commercial elements which of course need to fit, also a proper documentation of all legally relevant aspects of the project, which allow the investor to take over the developed property into his asset management in a smooth manner.

d. Asset Management, Property Management and Facility Management

Real estate portfolios are increasingly being acquired by an international group of investors. It is not infrequent that a real estate portfolio extends over a large area, if not across the entire Federal Republic of Germany.

It is often the distance from the home base that creates particular challenges for investor groups in properly managing the real estate they have acquired. The property must be maintained by employees with sufficient experience in German real estate, who are fluent in the language and are able to understand and implement country-specific laws, rules, and other provisions affecting it. In addition, there should be an extensive network available, particularly important in connection with leasing arrangements.

A competent employee must ensure that the property in question remains accessible.

Establishing a structure of this kind as an international investor in Germany involves significant cost, while still not guaranteeing that it will be possible to gain employees with appropriate experience for such a structure.

In addition, depending on the selected construction or structure of the acquisition of the real estate, it may be of importance whether an international investor has "business premises" in the Federal Republic of Germany. This often has negative effects with regard to tax optimization.

In case of larger real estate portfolios, a single business location is often not sufficient as far as accessibility of the property is concerned. Not least for purposes of cost saving and savings potentials, it has proven advantageous to outsource the operative management of the real estate portfolio. In particular, this also solves the problem of "business premises," with the objective of optimizing tax matters.

Usually, the services are broken down as follows:

Asset management represents the owner's interests and controls the other service providers on behalf of the owner. The asset manager provides for the real estate portfolio to be leased out and to be maintained in accordance with the lease agreements and the generally accepted standards of building and construction.

The necessary measures are carried out by property management and/or facility management. Their task is the commercial and technical administration of the property, including operation and maintenance of the building and the technical systems.

In the Federal Republic of Germany, there are no particular legal regulations that relate to asset management, property management, or facility management. The general provisions of the law on service contracts and/or work contracts can only be applied to these areas fields to a limited extent. Unlike in other international environments, there is also no general understanding of what the terms asset management, property management, and/or facility management actually refer to.

Nevertheless, the necessary contracts require close coordination and differentiated drafting.

The subject, scope, organization, and form of the respective tasks are manifold and depend on the individual case.

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In addition, asset management often also includes tasks from adjacent fields, such as rental services, brokerage activities, etc. Other legal provisions apply for these and must be adhered to.

3. Real Estate Finance

Finance transactions may include real property as security in multiple contexts. These brief notes on "real estate finance" will cover the topic only from a narrower and more specific angle, however, namely the typical structure of debt finance provided to professional real estate investors (or rather to special purpose vehicles set up by them), both in respect of single properties and portfolios.

a. Parties involved

Real estate finance in this sense is almost always on a non-recourse basis. Borrowers are special purpose vehicles owning real property (and, in addition, possibly holding companies). Finance is provided to them based on the value of the properties and related cash flows (rental income) rather than the general creditworthiness of the investors standing behind the borrower vehicles.

Lenders active in the German market are international and domestic banks and also other financial institutions, in particular insurance companies, which have shown an increased interest in the real estate lending market recently. Among banks, specialized mortgage banks *(Pfandbriefbanken)* deserve to be especially mentioned. These institutions are able to refinance their lending engagements in the capital markets by the issue of *Pfandbriefe*, i.e., covered bonds regulated by law. Due to the conservative lending approach imposed on these mortgage banks by the pertinent regulations and a resulting no-default history of the covered bonds (for more than 100 years), the mortgage banks have been able to raise funds in the capital markets and thus continue lending even in the recent financial crisis when other institutions had to reduce their activities significantly.

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Bigger amounts (roughly: €30 million upward) are mostly made available not by a single lender but rather by a syndicate of lenders, which may result in "club deals," in which the composition of the syndicate is already known at the time when the loan is negotiated and in which the several syndicate members actively participate in the negotiations (rather than leaving this task to a single arranger).

For the sake of completeness, it should be mentioned that debt finance can also be raised by the issue of (secured) bonds.

b. Documentation Standards

For property loan agreements, there is no one single documentation standard that is universally applied. Instead, one will find a range of different types of agreements, with short-form, term-sheet-like contracts that rely to a great extent on references to the lenders' general terms and conditions on one side of the spectrum and very elaborate contracts based on LMA (Loan Market Association) model agreements on the other. In 2015, the LMA has for the first time presented a specific model agreement for real property (portfolio) lending in Germany, which is governed by German law and takes account of the particularities of the German real property market, its legal framework and common practices. As of now, this agreement is available in both the English and the German language.

Between these extremes, a middle way has also gained some popularity, which attempts to spell out certain key elements in greater detail (such as financial covenants, provisions on property management, rent collection, bank account structures, payment waterfalls for moneys received and collected in these accounts, and the security package) and keep the remainder of the documentation reasonably short.

The Association of German Mortgage Banks *(Verband deutscher Pfandbriefbanken – VDP)* has prepared a model loan agreement following this approach, which is available on its website (in German and in English).

Usual financial covenants are a loan-to-value ratio (LTV) and an interest cover ratio (ICR) and/or debt-service cover ratio (DSCR).

Loan agreements with regard to properties in Germany will mostly be under German law, although agreements under English law exist as well (in particular if loans are arranged by international investment banks). Even if the agreement is under German law, it may nevertheless be in the English language in a transaction involving non-German participants.

c. Security and other Ancillary Agreements

The typical security package for property finance consists of mortgages or land charges, account pledges, pledges over the shares of the borrower(s) (and possibly holding companies higher up the chain), and the assignment of certain classes of receivables, including rent, insurance proceeds, future sales proceeds, and possibly warranty claims against the original seller from whom the property has been acquired (and potentially further parties).

If an entire portfolio of properties is financed, the security will normally be structured so as to achieve full cross-collateralization.

In particular if mortgage banks act as lenders, it is of crucial importance that mortgages or land charges are first-ranking, provided that "non-value-reducing" prior rights are acceptable. Easements in favor of local utilities regarding electricity of other supply lines are a good example of non-value-reducing rights, while easements granted to tenants will be viewed critically. The VDP has made recommendations how tenant easements should be structured in order to comply with lenders' first-rank expectations, and property owners are well advised to take these guidelines into account when agreeing on tenant easements, in order to make sure that the relevant property remains bankable.

In addition to security documents, there are usually subordination agreements in respect of claims of the equity investors against the borrower (e.g., dividend claims or claims under shareholder loans that have been provided) and duty-of-care agreements between the lenders and any property managers.

The security to be provided in connection with the financing has cost implications, because mortgages trigger notary fees and court fees for the registration of these rights, the amount of which is calculated in accordance with a statutory tariff depending on the transaction value.

Notary costs would also accrue for share pledges if the company whose shares are pledged is organized as a German limited liability company (GmbH).

XXI. Antitrust and Competition Law

1. The Act Against Restraints of Competition

German competition law has the objective of safeguarding the efficient functioning of the market. To achieve this goal, the German Act against Restraints of Competition (ARC) relies on structural control of concentrations between undertakings (e.g., mergers) and behavioral control of anti-competitive behavior of companies, either in the shape of unlawful cooperation between two or more undertakings (e.g., cartels) or anti-competitive conduct by one single undertaking with market power (mainly dominant undertaking).

Since 2005, the ARC has been extensively harmonized with the EU provisions (7th amendment to the ARC – *7. GWB – Novelle*).

Nevertheless, German competition law is not perfectly identical with EU law. As long as the EU provisions are applicable, these variations are of minor interest due to the supremacy of EU law over national law. In cases where trade between Member States is not affected, the EU provisions do not apply and the special rules of the ARC become applicable. One of the most important differences between the ARC and the EU provisions concerns the treatment of small and medium-sized companies. Under certain circumstances (set out under Sec. 3 ARC), cartels among small and medium-sized undertakings are deemed to meet the criteria of an exemption pursuant to Sec. 2(1) of the ARC.

Moreover, one has to keep in mind that with respect to the rules regarding unilateral conduct, EU Member States are allowed to adopt more stringent rules even where inter-state trade is affected.

2. The Enforcement Agency: Federal Cartel Office (FCO)

In Germany, responsibility for enforcing competition law (both with regard to EU and German provisions) lies with the Federal Cartel Office *(Bundeskartellamt)*, located in Bonn. The FCO is an independent higher federal authority. It is assigned to the Federal Ministry of Economics and Technology. The FCO has extensive investigatory powers under Secs. 57 – 59 ARC. The FCO takes its decisions through twelve Decision Divisions which decide independently and most of which are organized to reflect competences in certain market sectors.

Three of the twelve Decision Divisions deal exclusively with the cross-sector prosecution of cartels. Since 2002, there has been a Special Unit for Combating Cartels (SKK). It assists the Decision Divisions in the planning and implementation of investigatory measures (e.g., dawn raids) and in the increasingly complex evaluation of evidence. It is also the contact partner for companies wishing to apply for leniency in cartel proceedings.

The FCO takes part in the European Competition Network (ECN), the European Competition Authorities' (ECA) forum and the International Competition Network (ICN). Most intensively, the FCO cooperates with the Directorate-General for Competition (DG Comp) in Brussels.

Apart from the FCO, there are also competition authorities on the level of the different federal states *(Bundesländer)*. The respective agency prosecutes infringements the effects of which are limited to the specific *Bundesland* in question. In addition, the Federal Network Agency *(Bundesnetzagentur)* – an independent regulatory authority – is responsible for preventing practices amounting to an abuse of a dominant position in the telecommunications, post, electricity, gas, and railway sectors.

3. Cartel Agreements

The basic prohibition of anti-competitive agreements (Sec. 1 of the ARC) covers horizontal and vertical restraints as its EU counterpart, which is Art. 101(1) of the Treaty on the Functioning of the European Union (TFEU). Sec. 2(1) ARC defines the conditions for an exemption in line with Art. 101(3) TFEU. Sec. 2(1) ARC refers to the EU block exemption regulations which apply irrespective of whether trade between Member States is affected.

In cartel cases, the FCO is entitled either to order the discontinuation of the objected conduct or to impose fines. Other than the European Commission, the FCO cannot only impose fines on undertakings but also on individuals. Fines imposed on individual persons may amount up to €1 million, fines imposed on undertakings up to 10% of their annual revenue. Fines are imposed frequently, particularly in cases where companies have committed severe competition law infringements such as hard-core restrictions.

The FCO grants immunity or a reduction of fines to cartel participants who have cooperated to uncover a cartel. The Leniency Program sets out the conditions under which immunity from, or a reduction of, fines may be granted. The formal Leniency Program was issued by the FCO in March 2006. It applies to participants (natural persons, undertakings, and associations of undertakings) in cartels (in particular, agreements on the fixing of prices or sales quotas, market sharing, and bid-rigging). The FCO may grant immunity from fines if the following conditions are met:

- the immunity applicant was the first to approach the FCO;
- he has submitted his immunity application before the FCO had sufficient evidence to obtain a search warrant;
- he provides sufficient information (oral and written) and other evidence to enable the FCO to obtain a search warrant;
- he was not the sole leader of the cartel;
- he did not coerce others to participate in the cartel; and
- he cooperates with the FCO in a continuous and complete manner.

Cartel participants who submit an application after the filing of the immunity applicant may qualify for a fine reduction of up to 50% provided they submit incriminating evidence with value added and cooperate to the requisite legal standard.

Compared to other European competition agencies, the FCO has probably the largest experience with cartel settlements in which parties accept the facts and the agency reduces the fine by up to 10%. Contrary to the EU model, settlements are also possible in the case of vertical restraints. It is not a precondition to a settlement that all parties involved agree; hybrid settlements are quite common.

In April 2013, the Federal Court of Justice confirmed a fine of €380 million against the participants of the German cement cartel, the highest fine ever imposed by the FCO. In the same proceeding, the Court also confirmed the constitutionality of the ARC fine provision. It clarified that contrary to European competition law, the limitation in the ARC of the fine to 10% of the annual revenue of the involved companies has to be considered as a maximum value within a framework of fines, and not as a capping threshold.

4. Other Agreements

In January 2017, the *Düsseldorf Higher Regional Court* confirmed and in some cases even increased the FCO's fines against four confectionery manufacturers and an industrial association. The FCO had imposed the fines in early 2013 and mid-2014, because the companies involved had exchanged information on the state of negotiations with major food retail chains and to some extent on envisaged list price increases over several years. This is an important court judgement on information exchange since there had been no judicial review of the FCO's decisions before because there were no appeals against them or, if there were any, these were withdrawn again during the court proceeding.

In April 2017, the *Düsseldorf Higher Regional Court* confirmed the FCO's decision of principle against the running shoes manufacturer Asics. According to the decision, the general prohibition of the use of price comparison engines by retailers implemented through a (selective) distribution system amounts to a restriction of competition by object and is illegal. The court stated that the case law of the European Court of Justice (Pierre Fabre) was clear on this matter. The prohibition deprived the retailers of an advertising and sales possibility. The appeal court stated that the prohibition could also not be justified

on the grounds of protecting the company's brand image and pre-sale services because consumers of running shoes did not necessarily need or want such services or if so, could inform themselves via the Internet. The prohibition was a hardcore restriction which did not meet the requirements for exemption under European competition law.

5. Unilateral Anticompetitive Practices

With respect to unilateral practices, the German legislator has used, in Secs. 19, 20 ARC, its freedom granted by Art. 3(2) EU Regulation 1/2003 to go beyond the prohibition contained in Art. 102 TFEU. Accordingly, undertakings which have a certain market power, without being dominant, may not engage in discriminating behavior. This is the case in particular if small or medium-sized undertakings depend on the discriminating undertaking with market power. Irrespective of whether the company is dominant or has (only) market strength in relation to a small or medium-sized company, the FCO may order the company to discontinue the infringement or it may impose a fine.

6. Merger Control

The German merger control regime under the ARC is characterized by rather low revenue criteria: a combined worldwide revenue threshold of €500 million achieved by all undertakings concerned as well as two domestic revenue thresholds of 25 million and €5 million respectively achieved by at least one of the undertakings concerned, in all cases taking into account the revenue at group level. If the parties meet the combined worldwide revenue threshold, one party meets the domestic revenue threshold, but neither the target nor any other party meets the second domestic revenue threshold, a transaction will nevertheless be notifiable if (i) the transaction's size exceeds €400 million and (ii) the target has significant activities in Germany. This threshold was introduced by the 9th amendment of the ARC *(9. GWB-Novelle)* in 2017 and aims at catching acquisitions of start-ups without any or significant revenue in Germany – inspired by the Facebook/WhatsApp transaction, which would not have been notifiable there.

Notifications have to be filed ex-ante with the FCO. The FCO accepts notifications before the undertakings concerned have signed any binding agreements. Concentrations without any material effects on the German market are exempt from notification. The FCO takes the view, however, that this exception requires a restrictive interpretation.

Germany is one of the few jurisdictions where the acquisition of a non-controlling minority shareholding may give rise to a reportable concentration. This is the case where either the shareholding amounts to 25% or more of the capital or voting rights or where a shareholding below 25% confers an influence, which is competitively significant.

Until the merger has been cleared by the FCO, participating parties may not close or implement any part of the merger. In recent years, the FCO has toughened its policy against gun jumping. Should the FCO discover that a concentration has been closed without its prior approval, then it initiates a proceeding that may enable it to order the dissolution of the transaction if necessary. Apart from that, significant fines can be imposed even where there is no dissolution order. The usual statutory time limits do not apply in such a case.

Similar to the situation in EU law, German merger control proceedings are characterized by a division into two phases. In the first phase of one month, the FCO undertakes a preliminary examination to determine whether competitive problems might arise from the proposed merger. If that is the case, it initiates formal proceedings (second phase) which must normally be completed within four months from the date of notification. The second phase ends with a formal decision by the FCO to clear or prohibit the merger. Clearance may also be linked with obligations or conditions imposed on the parties.

As part of the 8th amendment to the ARC in 2013, Germany has revised its merger control rules. At the core of the reform was the introduction of a new substantive test, which prohibits mergers that result in significant impediment of effective competition (SIEC). The new test is modeled on the example of the EU's Merger Control Regulation (EC) No. 139/2004. Even after the reform has taken effect, however, German merger control retains certain peculiarities that prevent strict alignment of policies between Germany and the EU. In particular, the German practice continues to rely on substantive presumptions, a balancing clause and an exemption for markets defined as de minimis. Furthermore, concentrations that have been prohibited by the FCO may be granted ministerial approval by the German Federal Ministry for Economic Affairs and Energy. Given that German merger control has a notoriously far extraterritorial reach, these peculiarities continue to be of practical relevance for a large number of transactions worldwide.

7. Private Enforcement

Private enforcement of competition law through civil litigation becomes increasingly important. Germany is likely to develop as a favorable forum for cartel damages claims given the efficiency and transparency of German court proceedings. Furthermore, the legal costs are relatively moderate compared to other jurisdictions.

While class actions are not possible, a company may acquire claims from harmed customers to bring a court action, according to the case law of the Federal Court of Justice. A class action regarding the cement cartel initiated by CDC, a provider of legal services, was dismissed by the *Düsseldorf Higher Regional Court (Oberlandesgericht)*. The Court justified its decision mainly with the argument that the transfer of the claims was – pursuant to German law – invalid.

Private enforcement of German competition law was subject to reform under the 9th amendment of the ARC *(9. GWB-Novelle)* in 2017, implementing the EU Damages Directive. The reform introduced the following main changes to the already existing provisions on private enforcement, largely mirroring the Directive, but with some interesting deviations:

There is a statutory, rebuttable presumption that cartel infringements lead to damages. The presumption does not cover the amount of damages which may, however, (already under existing law) be estimated by the court.

The passing-on defense is available, but the defendant bears the burden of proof. Conversely, an indirect customer of a cartelist can rely on a rebuttable presumption that the damages were passed on.

The concept of joint and several liability of cartel members already exists, and the reform provides for limitations in line with the EU Damages Directive: Immunity applicants are generally only liable to their own (direct or indirect) customers; and cartelists that settled litigation with a customer are relieved from joint liability for the remainder of the damages (caused by non-settling cartelists) in that case (and protected against related contribution claims), in both scenarios only unless the other cartelists cannot pay. Small and medium-sized companies may also benefit from limitation of liability to their own customers under certain circumstances.

The claimant has a material claim for disclosure, even prior to litigation. In addition, the claimant can use interim relief proceedings for disclosure of a final decision by the European Commission or another national competition authority within the ECN. The defendant has a disclosure claim against the claimant regarding the passing-on defense, but only during ongoing litigation. In addition to the boundaries for disclosure set out in the EU Damages Directive (relevant, reasonably specific and proportionate in scope; leniency and settlement statements excluded), disclosure costs are to be reimbursed by the other party.

The statute of limitations is increased from three to five years.

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8. Procedural and Legislative Developments

9th amendment of the ARC *(9. GWB-Novelle)* finally came into effect in May 2017. The reform was triggered by the requirement to implement the EU Damages Directive into national law (see above), but the reform is much broader and also covers other areas of competition law. The law also slightly changes the revenue thresholds for merger control (see above) and even includes some industry-specific rules (e.g., exception from the cartel prohibition under national law for certain types of press cooperation and exception from merger control rules for certain public savings banks deals).

The reform allows fining a parent company for antitrust infringement of its controlled subsidiary in addition to fining the subsidiary (joint and several liability). Previously, the parent company could only be sanctioned, if it failed to prevent the subsidiary's infringement and thereby violated its own supervisory duty, which was difficult to establish. The reform aligns the approach to sanctions with the EU law concept of single economic undertaking.

The reforms also closes previously existing gaps of liability in case of legal succession, mainly regarding certain asset deals or internal split or spin offs (so-called "sausage gap" named after an internal restructuring used in the sausage cartel).

The FCO has obtained limited powers regarding consumer protection: it can carry out sector inquiries or inquiries into particular agreements across sectors in case of suspected significant, repeated and continuous infringements of consumer protection rules, affecting multiple consumers. It can also act as amicus curiae in related litigation. The FCO, however, will only have secondary power, i.e., to the extent that no other federal agency is competent to deal with these cases.

Useful link: · www.bundeskartellamt.de/EN/Home/home_node.html

XXII. Distribution, Franchising, Commercial Agents

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1. Statutory Background

The backbone of distribution relationships (B2B sales agreements, dealerships, distribution agreements, franchising, commercial agency, marketing, promotion and advertising) are the German Commercial Code, the Civil Code, the Law Against Unfair Competition and the Act Against Competition Restraints. In addition, a large number of laws and regulations regulate special legal and industry sectors, including consumer protection, print, online and broadcast advertising, sales prices and similar areas. Certain industry sectors are subject to special regulations (such as the medical products and pharmaceutical industries, health and safety regulations for chemicals, foodstuffs and electronic industries); see Section M XXXIII on Pharmaceuticals, Medical Devices, Health Advertising, Foodstuffs below.

2. Product or Services Distribution

Depending on the nature of goods or services imported into Germany, a foreign manufacturer or service provider would organize its sales to Germany through (i) a German importer, (ii) sales to a wholesale distributor, (iii) direct sales to German retail customers (single stores or chains, involving, at times, exclusive or non-exclusive selective distribution systems for branded goods), (iv) franchise contractors, or through (v) online direct sales to the German end user. There are no statutes specifically regulating distribution and franchise relationships. Commercial agencies, however, are regulated in substantial detail (see below).

Any of these commercial sales or sales support schemes can be set up by using a business owned by a third party (third party-owned distributor, franchisee, or third party-owned commercial agent) or by using a wholly or partly owned (subsidiary) business of the manufacturer (wholly or partly owned distributor, wholly or partly owned sales support facility operating as franchisee, commercial agent, sales outlet). Setting up sales and distribution arrangements through own direct investments, distribution and brand control may be greatly facilitated.

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3. Distributors

Distributors purchase and sell in their own name and on their own account. Business profits are generated through the difference between the purchase price and the sales price (margin). This applies regardless of whether the distributor is owned by the manufacturer (German subsidiary operating as distributor on the basis of inter-group pricing arrangements within applicable tax law) or whether it is owned by a third party. Purchase and resale are subject to freely negotiated prices.

There is no specific statute in Germany governing the framework and specific content of distribution relationships (exclusivity, marketing and promotion tasks, warehousing, minimum stock requirements, brand protection, after sales service, purchase and resale related terms, manufacturer/distributor guarantee terms, shipping terms, end user guarantee terms, minimum purchase obligations and the like can be agreed upon at will, subject only to general contract and fair trade rules). Fairly detailed distribution agreements are advisable. Some re-sale related terms are subject to the antitrust and competition control provisions of German and EU antitrust laws.

If a distributor is closely integrated into a manufacturer's sales and distribution organization, it may be entitled to a severance compensation at the end of the distribution relationship (analogous application of commercial agency rules, see paragraph on Commercial Agents below).

EU cross-border distribution relationships containing competition-restraining terms (such as purchase and/or supply exclusivity provisions, territorial or customer-related sales restrictions) are subject to certain restrictions of EU law (Articles 101 and 102 of the "Treaty on the Functioning of the European Union" (TFEU) of December 1, 2009 ("Lisbon Treaty") which is the successor treaty to what has formerly been commonly known as the EU Treaty). There are block exemptions for certain kinds of distribution relationships meeting specific conditions listed in the European Commission's Exemption Regulations (see Section XXI on Competition/Antitrust Law above).

4. Franchise

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Franchising is less developed in Germany than, for instance, in the United States or the United Kingdom. Most franchise agreements in Germany have a foreign origin or context.

In the distribution chain between (i) a manufacturer/original service provider, (ii) an importer, (iii) a wholesale distributor, (iv) a retail seller, and (v) the end customer, a franchise relationship may make sense in the final retail step in order to achieve uniformly branded and consistently organized retail sales outlets. The franchise terms enable the manufacturer to market its branded products or services uniformly by means of a typical and distinctive know-how developed for the presentation, promotion, marketing, servicing, sales support and for retail logistics. All of this needs to be documented to a degree that the know-how can be transferred to and compensated by a sales contractor (franchisee) which is willing to use the know-how under the prescribed conditions.

There is no particular franchise statute in Germany. Franchise relationships are regulated within the framework of competition/antitrust laws as well as, in the EU cross-border context, the relevant EU Regulations.

5. Specific Rules Relating to Commercial Agents

Germany has a long history of commercial agency regulation which is set forth in the Commercial Code. Commercial agents are defined as independent contractors appointed by a principal (manufacturer, service provider, importer, distributor), on a long-term basis, to solicit sales opportunities for the principal. The commercial agent may have the power to represent the principal by entering into a sales agreement on behalf of (in the name of) the principal (signing authority). Any sales are for the account of the principal. The earnings of the commercial agent come from a commission paid by the principal to the commercial agent (percentage of the sales price), or it can be a fixed compensation

(by piece sold or by time worked), in some cases it is a combination of both. Commercial agents assigned to a specific territory earn commission on all sales to that territory, regardless of whether the commercial agent was involved in the solicitation of the sales opportunity.

The duties and rights of the commercial agent and of the principal are set forth in detailed provisions of the Commercial Code (§§ 84 et seqq. HGB). Special attention should be paid to a set of rules governing a compulsory severance compensation payable by the principal upon request to the commercial agent at the end of the agency relationship (any ending, including expiration of term, either party's termination notice or an ending due to the agent's retirement, with only a few exceptions to this rule, such as terminations for breach on the part of the agent; § 89 b HGB). The maximum severance compensation is equal to the amount of commission earned by the commercial agent during one year, computed on the basis of the average commission earnings during the last five years (or any shorter contract period). The computation basis is the commission earned from newly acquired customers in the contract territory (or from any customer account significantly increased by the commercial agent). If the commercial agency agreement is subject to the laws of one of the EU Member States, and if the sales territory of the commercial agent is located within the EU, the severance compensation cannot be contractually excluded.

Useful links:

- www.franchiseverband.com/index.php
- www.franchise.de
- www.franchiseportal.de
- www.handelsvertreter.de

XXIII. Promotion and Advertising, Fair Trade Rules

1. Introduction

Germany's economy is based on the principle of free competition. Rules of fair play among competitors as well as reasonable consumer protection regulations are part of the successful market environment.

Promotion and advertising by any means (TV, radio, online, print, direct mailings, via telephone and telefax, at trade and industry shows and by means of promotional campaigns, sweepstakes, contests and the like) are successful tools of the advertising industries, supported by marketing and advertising agencies. Restrictions apply as regulated in the relevant codes and statutes.

Advertising restrictions are set forth in (i) the Law Against Unfair Competition (setting principal guidelines regulating fair advertising and trade practices), (ii) regulations regarding youth protection, (iii) TV, online and print media advertising rules, as well as (iv) special advertising restrictions in certain product sectors such as tobacco, alcohol, pharmaceutical and medical devices advertising. The Law Against Unfair Competition and other statutes and regulations are interpreted by case law. The law is mainly enforced by competitors and qualifying consumer protection and fair trade associations.

Heuking Kühn Lüer Wojtek is the German member of the Global Advertising Lawyers Alliance (GALA) that has its global administrative headquarters in New York (www.galalaw.com). This worldwide alliance of advertising and marketing law specialists provides national and international advertising localization services (advertising clearances) and specializes in quick and cost-effective turnaround of legal reviews of international advertising, marketing, and promotion projects.

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2. Selected Forms of Unfair Advertising

a. Unfair Forms of Comparative Advertising

Comparative advertising is commonly described as an ad that enables the reader or viewer to recognize (directly or indirectly) the advertiser's reference to a specific competitor or competing product or service. Current rules on comparative advertising originate from the European Directive 97/55/EC of October 6, 1997 which was adopted into German law on September 1, 2000 (Section 6 of the Law Against Unfair Competition).

Unless one or more of the following issues apply, comparative advertising is, in principle, a legal form of advertising in Germany, provided all factual comparative claims, as they will be conceived and understood by the average consumer, must be true, accurate and provable. If there is no practical way of proving the accuracy of a comparative claim or statement, the advertising is usually problematic. Evidence of accuracy must be readily available if the accuracy is questioned by a competitor or competent consumer association.

Comparative advertising is deemed unfair and illegal if a statement made in the context of the comparison:

(1) relates to a product or service which do not serve the same purpose as the advertised product (no comparison of different products or services),

(2) does not relate objectively to one or more features of such products or services which are (i) "essential," (ii) "relevant," (iii) "provable" and (iv) "typical" for the product or service.

Further, comparative advertising is illegal if it

(3) diminishes, in an unfair manner, the reputation of a competitor or if it unfairly disparages or degrades the products or services of a competitor or its personal or business affairs.

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In addition, comparative advertising must meet all other applicable advertising standards. The advertising claim must be sufficiently precise and clear so as to qualify for proof and evidence.

Procedural steps of a complaining party would involve a cease and desist request in which case the defendant can either deny the request or accept the cease and desist request through a formal cease and desist undertaking with a penalty clause. Time is of the essence. If deadlines are ignored, the complaining party would normally proceed to a request for injunctive relief which is available quite promptly.

Preliminary ex parte injunction orders are available in a matter of hours or a day. The injunction order may already be available to the complaining party when it first sends out the cease and desist request. If the request is rejected or ignored, the injunction can be served and enforced within hours. Any such court order has immediate effect and must be complied with regardless of any objections or appeals filed.

An injunction order is subject to "objection" of the defendant party (filed with the court that has issued the injunction order). The merits are reviewed in a court hearing. The court then renders (normally on the day of the hearing) an injunctive judgment which either confirms or lifts the original ex parte injunctive order.

The winning party is entitled to reimbursement of its statutory legal fees which normally range between €2,000 and €3,000, depending on the "value" of the case. The losing party pays also the court costs (similar amount).

In parallel to the preliminary injunction procedure, there may be "principal proceedings" (normal cease and desist complaint in a regular court action) aiming at the final resolution of a dispute (as opposed to the quick, preliminary resolution by injunctive decision). In unfair competition matters, such main court actions are, however, rarely applied for because the procedure is too lengthy and costly in most cases (duration of nine to twelve months in the first instance,

legal fees and court costs in the area of between about €8,000 and €15,000 or more; the exact fees depend on the court-determined "amount in controversy" which governs the statutory fees set forth in the statutory legal fee and court fee schedules, and further depend on the steps taken in the course of the litigation.

In terms of damages and other risks, except for the obligation of the losing party to bear all costs of the proceedings, there are no significant financial risks. Only the above statutory fees (not any higher hourly fees) are reimbursable by the losing party.

There is normally no claim for damages because it is often difficult to quantify damages in unfair advertising cases.

In theory, there is the possibility of a court order to the effect that the defendant must surrender to the government the profit earned from an intentional material violation of fair advertising rules causing severe damage to consumers (Section 10 Unfair Advertising Act).

In unfair advertising cases, there is normally no criminal liability risk because there are no criminal sanctions except in situations where there is intentional misleading of the public. This is rarely prosecuted.

b. Other Unfair Trade Practices

Sections 3 et seqq. of the Law Against Unfair Trade Practices (UWG) and the Annexes to the Law address a variety of acts that may constitute an unfair business practice and are, therefore, prohibited. The main forms of this unfair behavior are:

Exploitation of Gambling Instincts

This rule relates to contests and sweepstakes if they create undue psychological compulsion as an effect of the chance to win an excessively valuable prize. A similar issue may arise if entrants are lured to the sponsor's premises and are required to speak to sales personnel in order to be able to participate in a sweepstakes or contest.

Exploitation of Inexperience, Advertising to Children

Advertising addressed to inexperienced persons may be deemed unfair if the promotion exploits such inexperience. The term "inexperienced persons" includes persons that have no experience in legal or business matters, particularly children and adolescents.

There is no general prohibition of advertising directly to children. There are a number of restrictions, however, relating to the content of such advertising directly to children (i.e., Section 4 number 2 Law Against Unfair Trade Practices: No exploitation of inexperience of children and adolescents, no advertising directed at children for the purpose of asking parents to purchase etc). Restrictions also apply to television advertising in children's programs which would be considered advertising directly to children. Advertising "directed toward children" is any advertising which is either placed in children's magazines or children's TV programs, or any other advertising which specifically addresses children (in terms of content or appearance). There is no statutory or regulatory definition in place.

Children may not be targeted in advertising for the purpose of influencing their parents in their purchasing decisions or to address them as potential purchasers. A "child," according to Section 1 of the "Youth Protection Law," is a person below the age of 14. This definition applies to Section 3 of the Youth Media Protection Treaty among the German States (Interstate Treaty on the Protection of Human Dignity and Minors in the Media). An adolescent is an individual who is 14 years of age but is below the age of 18 (Section 1 Youth Protection Law and Section 3 Youth Media Protection Treaty). In addition, occasionally reference is made to a "minor" which is not defined. According to Section 2 of the German Civil Code, a minor would be an individual below legal age which is the age of 18 in Germany.

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Certain special restrictions of advertising in television, radio, cinema, games and other advertising relate to children, adolescents and minors as defined above.

Advertising "directed towards children" is addressed in the Youth Media Protection Treaty and (self-regulatory) rules of the German Media Supervisory Bodies *(Landesmedienanstalten)*. The State Media Authorities control private broadcasting organizations in accordance with self-regulatory guidelines [see particularly Section 46 Interstate Treaty on Broadcasting and Telemedia *(Rundfunkstaatsvertrag)*]. In effect, there is no material difference in the legal framework of different types of media as to what is considered advertising directed towards children.

Video games and internet-based games are regulated through certain in-game advertising rules governed by EU Directive 89/552 of October 3, 1989 ("Television Without Frontiers Directive"), Directive 2007/65 of December 11, 2007 ("Audiovisual Media Services Directive"), Directive 2005/29, dated May 11, 2005 ("Unfair Commercial Trade Practices Directive"), Directive 95/46 of October 24, 1995 ("Data Protection Directive"), and national laws relating to unfair trade practices (prohibition of hidden advertising, restrictions on misleading product placement in advertising), as well as certain youth protection rules established by Section 12 of the Youth Protection Law and Section 6 of the Youth Protection Media States Agreement).

Limits apply to advertisements for films and video games based on ratings. There are rating organizations for films and video games: Voluntary Self-Regulation of the Cinema Industry *(Freiwillige Selbstkontrolle der Filmwirtschaft GmbH in Wiesbaden – FSK)*; Entertainment Software Self-Regulation Association *(Unterhaltungssoftware Selbstkontrolle e.V. in Berlin – USK)* applying the Youth Protection Law as well as self-regulatory rating rules relating to online and offline games, firms and television programs.

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Nuisance and Harassment

The unsolicited delivery of unordered goods may be illegal unless both parties have a standing business relationship in which the addressee normally expects such deliveries. Except where the goods are of insignificant value, even if the addressee is informed that he has no obligation to pay for the goods received, such unsolicited distribution of goods may be an unfair business practice.

Excessive Exploitation of Emotions

Advertising is often directed to the subconscious and to emotions. Appealing to emotions by itself is not prohibited if the advertising is not misleading and if the targeted emotions have a functional relationship to the goods or the services offered. Advertising appealing to the addressee's emotions is unfair and illegal if it promotes segregation, unequal treatment or violates privacy rights.

Misleading Statements

Misleading statements on the nature, the origin, the manner of manufacture, or the pricing of goods or commercial services, or on the offer as a whole are illegal. This applies, for instance, to information in price lists, the source of goods, the possession of awards or the size of the available stock.

Enticement

It may be Illegal to excessively influence a purchase decision through measures that are alien to the concept of "competition by performance." That means, the promotion and advertising of goods or services must be based on its features such as quality or price and not on other factors which are unrelated to the advertised goods or services. The promotion of sales through money gifts, coupons or vouchers can constitute unfair competition if the benefit exceeds normal rebate scenarios.

The question of whether a promotional act violates fair trade practices is a matter of all relevant circumstances of the promotion or offer. In order to evaluate

a promotion for fair competition compliance purposes, all aspects of the appearance and impression of the advertising must be taken into consideration.

3. Rights Clearance in Promotion and Advertising

As a general rule, all materials used in advertising must be free and clear of the rights of a third party which have not been licensed for the intended use.

a. Using pictures of buildings or other copyrighted works located in public places

Sec. 59 German Copyright Act permits the distribution and public presentation of paintings, drawings, photography and motion pictures (created or taken from publicly accessible places) of the outside/surface of copyright-protected works placed permanently in public places such as roads and streets. That means any such materials can be used in an advertiement (subject, of course, to any rights of the creator of the work such as the photographer or painter). Views of the inside of buildings are not included.

b. Celebrity Advertising, Personal Images

Rights against the unauthorized distribution or publication of an image are increasingly enforced by celebrities and sportsmen if there is a commercial exploitation involved (as opposed to news and other editorial reporting).

Any individual is protected by the "right in one's own image" in accordance with the provisions of the Art Copyright Law *(Kunsturhebergesetz – KUG)*. The KUG is the predecessor of the current Copyright Act. Its provisions on the "rights in one's own image" survived, all other parts of the KUG were replaced by the current Copyright Act.

In short, the *KUG* stipulates that pictures of an individual may not be published or distributed except with that person's consent. That applies to commercial and non-commercial use.

This general prohibition does not apply to pictures that depict an event of historic nature, past or present (§ 23 paragraph 2 No. 1 *KUG*). This includes pictures of "persons who are part of contemporary or past history."

The courts make a distinction between "absolute" and "relative" persons of current or past history. Absolute persons of current or past history are those whose participation within public life subjects them generally to a public information interest (such as actors, politicians, top sportsmen, and also well-known persons in business and commerce). With respect to these absolute persons of current or past history, the courts assume permanent public interest in these individuals. For this reason, the publication or distribution of their likeness is not subject to their consent, provided the distribution or publication serves a particular public information interest. That distribution or publication may also serve a commercial interest but there must always be a substantive, topical or editorial concept and context (BGH NJW 1979, 2203, 2204 – Soccer Player Calendar). If there is no such editorial concept and if the individual depicted becomes degraded to a mere object of commercial interest, the individual's consent is required.

Relative persons of current or past history are subject to a public information interest with respect to a specific event only. Free distribution and publication is limited to coverage of that particular event.

A picture showing a sports team (rather than single players) would not be considered an infringement of individual rights in a person's own image if the object of the picture is clearly a team or team situation rather than the individual. There are no definite rules, though, which would reliably eliminate the risk. The legal evaluation depends on the nature of use of a picture and the role an individual image plays in that context.

The consent required may be made available by the relevant individual through an agency. Proper due diligence regarding the existence of consent is required.

The costs risk in the event of a violation of an individual's rights is very much governed by the German statutory fee and court cost schedules. For example, if the value of the case (that determines the level of fees and court costs) is a standard value of €100,000, the total legal fee exposure (own legal fees and winning party's legal fees) would be in the area of €8,000. Court costs would be in the area of €3,000. Somewhat higher fee and cost levels apply in the appeal instance.

Post-Mortal Privacy Claims

The regular statutory privacy protection of a person's image (see 2. below) is limited to ten years from the individual's death. In addition, by case law, there is a "post-mortal" privacy claim which was created to preserve respect of a deceased individual in the sense that it should be protected against gross defamation and degradation. That claim exists so long as there is a justified interest (as long as there is active memory in the deceased, not if personal memory has faded.) Mere commercial use as such is not a gross defamation or degradation in the sense of this post-mortal right under German law.

The calculation of damages is not regulated but is subject to court precedents taking into account the amount of a hypothetical royalty had a proper license been obtained, as well as the circumstances of the case and any harm done by the unauthorized publication or distribution. Damages could be anywhere between about €2,000 and €200,000 or more, just to give a range. In Germany, it is generally difficult to establish a right to substantial damages; there are few cases where a million euros has been awarded. On the other hand, there is a clear tendency to award higher amounts in situations where the image is being abused for unrelated commercial purposes.

4. Ambush Marketing

Ambush marketing usually involves unauthorized advertising in the context of a major sports or other event financed by sponsors which draws upon the image and reputation of the event. Some define it in more restrictive terms and require that the advertising purports the advertiser's own involvement or any association with the organizer of a sponsor or otherwise. In between, all sorts and degrees of misleading ambush advertising are conceivable.

There is an ongoing debate in Germany as to what constitutes illegal ambush marketing and what is permitted independent marketing. Unauthorized use of an event organizer's trademark is certainly the clearest case of ambush marketing – even though one must carefully check whether the event organizer's trademark is really valid and enforceable. There have been some quite interesting court decisions on this point because suspected ambush marketers have been quite successful in destroying the trademark base for alleged ambush marketing claims.

Even if no trademark or tradename is used by an ambush marketer, the marketing may still be illegal if other rights are infringed upon. What these other rights could be is heavily debated. For example, the soccer organization UEFA is famous for prosecuting ambush marketing quite rigorously and states so in its rights protection program.

An event organizer's policy to that effect does not necessarily have to comply with applicable laws. In fact, the question remains open In Germany, as to what constitutes misleading advertising (issue of fair trade law protecting the public and the competitor) and what constitutes illegal exploitation of given rights of the event organizer (issue of proprietary rights of the organizer).

German law relating to ambush marketing is based on EU Directive 2005/29/EG Concerning Unfair Trade Practices.

On that basis, not any advertising or marketing in the context of a major event is illegal ambush marketing. Illegal is definitely an act that falls into the "Black List" (Annex to § 3 III of the Directive). If any of that is contained in a press release or press coverage qualifying as advertising, a cease and desist request may be justified, particularly if a press release or press coverage fulfils No. 4 of the Black List (publishing misleading claims as to any endorsement, support, authorization, acceptance or admission by another). Of course, statements to that effect will rarely be clear or straightforward, there is much evaluation and discretion involved before a judge would rule a published claim as falling under No. 4 of the Black List. One could say, however, that an advertising press release does not fall under No. 4 if there is no direct or indirect statement to the effect that the content of the release or the advertiser is authorized by the event organizer.

One would check In Germany specifically Section 5 paragraph 1, No. 4 of the German Law Against Unfair Advertising which prohibits, in advertising or any other commercial activity "Claims and symbols which fall in the context of direct or indirect sponsoring or which refer to an admission of the advertiser or its goods or services."

There are no relevant court cases which could assist in making a clear distinction between independent press release advertising and press release advertising that falls into the above scope of illegal ambush marketing. It is fair to say, however, that based on the language in the Directive and Sec. 5 of the German Law Against Unfair Advertising, the court will definitely require a relatively clear statement or impression to the effect that the advertiser is acting as an authorized affiliate of the event.

5. The Double Opt-In Requirement to Verify Necessary Online Consent

For purposes of protecting consumers and business parties against unsolicited advertising (by telephone, email, fax, text messaging, or by any other electronic means) German fair trade laws prohibit certain advertising by the above methods to a person who has not given his prior consent.

This applies to straightforward product and service advertising as well as promotions, newsletters, sweepstakes, contests and the like which are distributed for the purpose of advertising a product or service or just the image of a business.

Any distribution of advertising in violation of the above consent requirement can be prosecuted by cease and desist demands (and cease and desist court injunction) and/or by regulatory fines.

On the background of this consent requirement, the courts have developed the rule that a party responsible for the transmission of an advertisement to a party claiming that it did not consent to receiving such advertising must prove that the complaining party had, in fact, personally consented to receiving advertising from the sender.

Such proof often fails because even if there was an apparent online consent (by ticking an opt-in box and stating an email address and/or telephone number), there are instances where such opt-in and email address and/or telephone number do not belong to the party that has received the advertising in the end (due to various reasons such as typing errors of numbers, use of a third party's email account or other contact details (children using their parents' accounts), intentional misrepresentations to do a third party a favor by signing it up to a sweepstakes, etc.), so that the party that has received the advertising was, in fact, not the party that has communicated consent. In case of such false consent, the courts hold the advertiser responsible, pointing out that there are ways and means to reasonably verify the origin of a consent

This burden of proof requires advertisers to use a double opt-in process (also called "close-loop authentication") which means that if the advertiser has obtained an online opt-in consent to receiving advertising, it would send (electronically) to the account/address of the original opt-in a request for confirmation of

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the original opt-in. Only if it has received, as a response from the email account used for that purpose, confirmation stating an identical name, address, phone number or other means of identification ("a double opt-in"), it would use that email address for its future advertising purposes. A similar procedure applies in case of telephone, fax, text messaging, or other transmission means.

The courts in Germany have largely accepted (and even required) this double opt-in process as a reasonable measure to obtain sufficient proof of a party's consent (sufficient verification that the consent actually came from the party identified in the original consent). Some courts even require the double opt-in process regardless of the use of other verification means.

The double opt-in process is not prescribed by statutory law. Only because it is today a commonly used practice, it is recommended to use that process in connection with online or other electronic communication with parties whose addresses are intended to be used for advertising.

Useful links:

- www.galalaw.com
- www.marketingverband.de/
- www.ddv.de
- eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:149:0022:0039:EN:PDF

XXIV. Intellectual Property

1. Technical Inventions – Patents, Utility Models

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a. European and German Patents

In accordance with internationally available standards, German national patents may be obtained for technical inventions by filing a national patent application with the German Patent and Trademark Office located in Munich. Patent protection can also be achieved with respect to many European countries (EU Member States and others) by applying for a European Patent. That application is filed with the European Patent Office, which has its main office in Munich, Germany, as well. As a general rule, the application procedures at the German Patent and Trademark Office are quicker than those at the European Patent Office. Applicants tend to file a German national patent application in addition to the European Patent application in order to achieve patent protection as early as possible. In addition, national patent protection can be achieved by means of the international PCT patent application procedures.

b. EU-Patent – European Patent with Unitary Effect

There is no European Patent with Unitary Effect yet. Much has been written about it, however, and it even made it into daily papers. The reason for this is simple: It would fundamentally change the patent system in Europe. The relevant agreement was signed in December 2012, but at the current time it is not certain if, when, and in which countries it will enter into force. This will depend also on the political development within the European Union.

c. Utility Model Protection

In addition to the patent, there is the utility model, which is also a registered intellectual property right for technical inventions. It can be combined with a patent application. In difference to a patent registration, there is no ex- amination by the Patent Office of whether the application meets the conditions required for a patent; the utility model is registered on the basis of the statements contained in the application. The German Patent Office does not conduct any search, and

patentability is not examined. As a consequence, a utility model is usually registered within a few months. This enables the applicant to achieve an enforceable registered IP right relatively soon and in any case sub- stantially earlier than a patent. A further advantage is that a utility model might stay enforceable even if the parallel patent happens to become exposed to a successful annulment action. Public prior use of the invention may jeopardize a utility model registration only if the prior use took place in Germany. In contrast, European and German patents are at risk if the public prior use took place anywhere in the world.

d. Enforcing Patents and Utility Models

Patents and utility models can be enforced through judicial proceedings at twelve German regional courts with specialized patent chambers. The most important venues for the enforcement of utility models and German or European patents are Düsseldorf and Mannheim. As a matter of fact, Düsseldorf is the most important venue for patent litigation not only in Germany, but throughout Europe.

One of the most relevant particularities of the German patent enforcement procedures is the fact that a court involved in an infringement action would not decide on the validity of the underlying patent. It considers the patent valid until the validity of the patent is successfully contested in a separate opposition or invalidation procedure. For that purpose, an invalidation request can be filed with the Patent Office in a patent opposition procedure, or with the German Federal Patent Court in an invalidation action. Generally speaking, this system is friendly to the patent owner. Regarding the relatively quick in- fringement procedure before our highly competent and specialized courts at reasonable court fees, *Düsseldorf Higher Regional Court* is a preferred venue for patent enforcement procedures.

Utility models can be enforced in the same way but the court involved in the infringement action can decide itself inter partes on the validity of the utility model.

e. Preliminary Court Injunctions – Protection During Trade Shows

Patents can be enforced in accelerated court proceedings aimed at injunctive relief. If there is the immediate risk that a patent will be infringed upon (e.g., in the context of a trade exhibition where an infringing product is advertised or presented), the patent owner can seek a preliminary injunction order. If properly applied for, injunctions can be issued within 48 hours and “ex parte” without oral hearing. This is an effective tool against counterfeit and other infringements. The application requires diligent preparation. Documentary evidence and written witness affidavits must be attached.

Looking at it from the other side, a business that finds itself exposed to the risk of a possible injunction order being issued against it may file a protective brief (*Schutzschrift*, caveat) in order to ask the court not to issue an injunction without first holding an oral hearing. The court will consider the request and reasons stated in it, but is not bound by it. It may issue an injunction without hearing if this appears necessary after all to temporarily preserve the rights of the applicant. A *Schutzschrift* may still help to avoid timely serving and enforcement of an injunction during a trade show, and it may possibly also help to avoid the injunction in the first place. As a consequence, the filing of a *Schutzschrift* is common practice if the potential defendant notices the risk of a legal dispute through a cease and desist request or otherwise.

f. The Right to Inspection

If the patent owner can show that patent infringement is probable, even though the ultimate evidence may be still missing, he may submit an application to the court to have an expert be appointed to carry out an inspection, e.g., at the production facilities or the booth at a trade show. He is even able to gain entry by force with the help of the police. An inspection order will not be issued based upon a general request, but instead the application must include an accurate description of what the inspecting expert is allowed to take with him/her into the facilities, and what s/he is allowed to do there.

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g. Software – Copyright Protection

In Germany, patent protection is not available for computer software as such because it is not considered a technical invention. Only if computer software is combined with a technical device (e.g., a specific machine which is operated by means of the software), can patent protection be sought for this combination.

Computer software is automatically protected by copyright, however. The German Copyright Act does not provide for registration of copyrights; the protection starts automatically with the creation of the work. In the case of computer software, it may be advisable to deposit the source code with a third party such as a notary in order to be able to furnish evidence for the identity of the creator and the date when the creation was made.

2. Trademarks, Design Protection, Counterfeit, and Product Piracy

The upside of business in new markets is winning new customers and recognition of brands and products. The downside is the risk of counterfeiting and piracy.

In the Internet age, your own trademarks as well as product designs and fashion trends may be in every corner of your target markets before you have even put a foot on the ground. You are well advised to arrange for local brand and design protection as early as you can. Although trademark and design protection are well developed in Germany, it is always good to take reasonable precautions.

a. Trademarks

Even though your brand and products may have protection in your own country, the intellectual property relating thereto is not automatically protected elsewhere. Local or international registrations are required. In certain circumstances, your home registration does help, however, to obtain time priority for a later foreign registration.

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German trademark protection may be obtained in a number of ways. The safest way is trademark registration in the relevant trademark register (national German Trademark Register, European Community Trademark Register, or International Register under the Madrid System). If there is no registration, a product designation may still enjoy protection if it has gained a secondary meaning as a trademark, i.e., if it is well known to a relevant number of businesses and consumers in Germany. This will almost never be the case, however, if a trademark has not yet been used in Germany.

To apply for a national German trademark, an application must be filed with the German Patent and Trademark Office. The filing fees are insignificant. There are no filing restrictions for foreign applicants, and registration can be achieved quite quickly. Under the accelerated procedure, registrations may be completed within days from filing. Not only sufficiently distinctive words can be protected as trademarks, you can protect distinctive colors, designs, or a specific two-dimensional or three-dimensional shape of your product. The common requirement is sufficient distinctiveness (ability of the mark to identify an origin of the product or service for which the mark is used).

To apply for a Community Trademark, an application must be filed with the Office For Harmonization in the Internal Market (OHIM). The filing fees are, of course, higher than those for a German national registration. The procedure is usually more time-consuming. One should also note that if there is a successful opposition against the application from any one or more Member States (based on a prior identical or confusingly similar national registration in that State), the whole process is terminated and can only be continued as individual national applications in the EU Member States from which no successful opposition has been filed. Moreover, the application will only proceed to registration once all oppositions are completed. If the filing process is completed, however, the owner of the Community Trademark enjoys protection in all EU Member States.

To apply for an International Registration under the Madrid Convention and its Protocol, filing with the national Trademark Office at which your basic registration is on file is required. It should be noted, however, that your Community trademark may also serve as basic registration. There is no International Registration without prior basic registration. The International Registration means that your basic registration is extended to the signatory countries of the Madrid Agreement or Protocol, which you have identified in your application. Trade- mark protection is available in Germany for 10-year periods (unlimited multiple extensions are possible).

The trademark grants protection from the "priority date" which generally is the filing date, but a trademark can be enforced against a third party only upon its registration.

b. Designs

Generally speaking, for a period of three years from first placement on a market within the EU, the design or shape of products is protected by a non-registered EU design right, provided there has been no product on the market that has a confusingly similar design (similar overall impression). This non-registered EU design right does not come into existence if the design has been published in another country before it was first introduced on a market within the EU. Manufacturers with global product launches should, therefore, arrange for registration of the relevant design in order to avoid priority issues.

German and EU design protection rules provide for a one-year grace period from the first market placement of a design anywhere in the world within which the creator can file for registration without facing the obstacle of lack of novelty.

Registrations may be applied for with respect to all EU Member States (Registered Community Design, RCD), or as a local German design right. There is an international treaty on design rights, of which Germany is a member. The international registration, however, is not as popular as its counterpart for trademarks because there are not that many signatory countries.

There is no official examination of novelty or third-party priority rights by the relevant registration offices. In the event of a conflict with a prior third-party registration, the validity of the registration (novelty and priority issues), as well as the infringement issues of the case pending before the court, will be reviewed by the court.

Filings will automatically lead to publication of the registration in the relevant jurisdiction. The applicant may include in one single application a series of designs and can thereby arrange for an inexpensive protection of an entire collection or product line.

Certain additional but limited protection of products or services against illegal acts of passing off and piracy is provided by the German Law Against Unfair Competition (unfair bad faith exploitation of someone else's work products).

c. Enforcing Trademark and Design Rights

Owners of trademarks or design rights can enforce their rights before the German Civil Courts. Infringement claims are generally based on the confusing similarity of the relevant trademarks and designs. Unauthorized parallel imports as well as unauthorized repackaging or modification of genuine products may also lead to infringement claims.

If court assistance is urgent, injunctive relief is available. The applicant may ask the court to issue a cease and desist order and to order the defendant to promptly disclose the name and address of the supplier as well as quantities, prices, and other relevant details of illegally ordered, purchased, and sold products. The court may also grant a seizure order, which can be enforced by a bailiff on the infringer's premises or at other locations (e.g., trade shows).

Owners of trademarks, design right registrations or other IP rights may also file an application with the German customs authorities, which maintain an electronic database that enables customs inspectors to investigate infringement situations. Customs examines millions of goods every day. Where goods are suspected to

infringe upon a trademark or other IP right that has been notified to customs, these products will be temporarily seized, and the owner of the relevant IP right will be notified. The rights owner will then also be able to take legal action, either before civil courts or by filing a request for criminal proceedings against the importer. Illegally imported and seized products will be destroyed by customs, if legal action has been taken against the importer or if no objection has been raised against the seizure. Similar applications for customs action may be filed with customs with respect to parallel imports. Organizing the above customs surveillance is an effective tool for rights owners to prosecute infringements and keep infringing products, particularly counterfeits, out of the market. This can help to reduce the cost of prosecution in trade locations such as warehouses, shops, and Internet platforms.

3. Copyright Law

Recently, the Federal Court of Justice has decided that copyright protection extends to certain average product designs as works of applied art. As a result of this decision, the scope of protection under the Copyright Act has increased significantly.

The Copyright Act protects authors and creators of works of literature, science, and of the arts. A protection is not a matter of work quality in a technical or practical sense but a matter of creativity and intellectual effort that has achieved a certain level of originality of the work.

Protected works are – among others – books, music, paintings, but also computer programs, or pieces of applied art (such as the "Kitchen Aid"), but also databases, etc. The term "work" is not fixed but develops with technical progress and other changes in arts and everyday life. It is open for innovation and includes, of course, forms that were not known at the time the Copyright Act was adopted.

Especially the entertainment industry is depending on the protection provided by copyright law because only a small part of the works created in this segment can be adequately protected by trademarks or patents. One must bear in mind, though, that an idea as such is not copyright-protected. In Germany, one cannot copyright protect a business idea as such, as is possible in certain respects in other countries such as the United States of America.

If the eligibility of a work for copyright protection is in dispute, only the courts would decide whether a given work is covered by the Copyright Act. In Germany, there is no examination and registration of copyright works. The date of publication of a created work is decisive and should be documented in a court-tight manner, in order to be able to proof first publication in case the creation and time of creation are in dispute.

A copyright comes into existence with the creation of a qualifying work. The duration of protection depends on the type of the work. In general, the copyright of an author or creator expires 70 years after his or her death. During the term of the copyright, the author can decide if and how he or she wants to publish, reproduce or distribute the work. The author can also choose to publish under his or her own name or under a pseudonym, or to stay anonymous. Once the author has decided to sell his or her work (e.g., a painting), it can be distributed further without the author's consent. Alternatively, an author may grant a license to use the work on a non-exclusive or exclusive basis. Granting rights with respect to yet unknown forms and methods of use is possible and common. It is important to note that the author may in certain circumstances claim additional remuneration e.g., where the work is used in new, previously unknown ways of dissemination or where a work (e.g., a novel) is unexpectedly successful, so that a previously agreed compensation becomes grossly inadequate.

Since authors often cannot keep track or control the use of a work to demand appropriate remuneration, any author or creator can join one of the collecting societies administrating the compensation payable for the use of works in different categories of works, such as *"GEMA", "VG Wort", "VG Bild-Kunst", VG Musikedition"* and others. The German Patent Office provides a list of acknowledged

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collecting societies (www.dpma.de). Since 2016, the regulation of the work of the collecting societies has been revised by the Law of the Collecting Societies *(Verwertungsgesellschaftengesetz)*.

The author's exclusive rights are limited in some respects by statutory law. For instance, certain temporary use, private use, as well as use in education and research may be permitted without the author's consent.

Enforcing Copyrights

Copyright owners can enforce their rights before the German Civil Courts similar to trademark owners. Infringement claims are generally based on plagiarism.

If court assistance is urgent, injunctive relief is available. The applicant may ask the court to issue a cease and desist order and to order the defendant to promptly disclose the name and address of suppliers as well as quantities, prices, and other relevant details of illegally ordered, purchased, and sold copyright products. The court may also grant a seizure order which can be enforced by a bailiff on the infringer's premises or at other locations (e.g., trade shows). Seizure of infringing goods by customs is available in copyright matters as well (for further details, see above in the trademark chapter).

Useful links:

- www.wipo.int/portal/index.html.en
- https://euipo.europa.eu/ohimportal/en
- www.dpma.de
- www.epo.org
- www.heuking.de/eu-patent
- https://www.heuking.de/en/focus-of-activities/european-unitary-patent.html

XXV. Data Protection

1. General

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In the EU, the biggest reform of data protection law since its existence was decided in 2016. After an over four-year legislative process, the EU General Data Protection Regulation ("GDPR") was enacted as Regulation No. 2016/679. The GDPR will be directly applicable in the entire EU from May 25, 2018 on.

As an EU Regulation, the GDPR supersedes within its scope all national data protection laws.

The Federal Data Protection Act *(FDPA, Bundesdatenschutzgesetz; BDSG)*, which was based on the data protection rules of the 1990s and as modified in 2009, will presumably be inapplicable soon. Currently, the German legislator is working on an act which is designed to adapt the remaining German data protection law to the GDPR *(Datenschutz-Anpassungs- und -Umsetzungsgesetz "DSAnpUG")*. It is unclear, however, whether the lawmakers will manage to pass the bill before the federal election in the fall of 2017.

The Telecommunications Act *(Telekommunikationsgesetz, TKG)* and the Telemedia Act *(Telemediengesetz; TMG)*, the Social Security Code *(Sozialgesetzbuch, SGB)*, the Measuring Point Operating Law *(Messstellenbetriebsgesetz, MsbG)* governing inter alia smart meters, and many more specific acts contain specific data protection provisions. Until May 2018, these specific provisions take precedence over the provisions of the FDPA and will, thus, directly be applicable. Most of the specific national data protection laws will also be superseded by the GDPR from May 2018 on, however. The GDPR provides several clauses which permit the Member States to enact own data protection rules in certain areas, for example in regard to telecommunications and social security.

As a principle, data may only be (i) collected, processed and used to the extent required by the party controlling the collection, processing and use of the data (the "Data Collector"), (ii) data must be deleted if not required any more by the

Data Collector, and (iii) data must be collected directly from the data subject and not from any third-party sources.

2. Scope of the FDPA and the GDPR

The provisions of the German FDPA and the GDPR apply to data collectors located within Germany or outside of the European Union (EU) / the European Economic Area (EEA). If the Data Collector is located outside Germany but in another EU or EEA Member State, the provisions of the FDPA apply if the Data Collector collects, processes or uses the personal data through a German branch office.

Additionally, the GDPR is applicable if a company located outside of the EU offers services or goods to persons located within the EU. All data processing within this frame must fully comply with the GDPR

3. Fines

The possible fines for a violation of data protection law will rise dramatically under the GDPR. Until May 25, 2018, fines for data protection offenses range from €50,000 to €300,000 with higher amounts possible in severe cases which permit the collection of generated profits.

Under the GDPR, fines of up to €20 million or 4% of the worldwide annual revenue (whatever is higher) are threatened for violations of the GDPR. In addition, more violations of data protection prvisions are subject to fines than currently.

4. Overview on Duties of a Corporation Under the GDPR

Companies must, among others, fulfill the following:

- Implement appropriate technical and organizational measures to ensure compliance with the provisions of the GDPR (Art. 24 GDPR) => This obligation leads to the fact that each company requires an appropriate – for the size of the company and the respective data processing operations – data protection compliance management system.
- Special compliance duties (appointment of a data protection officer, keeping records of processing activities, performing a data protection impact assessment) according to Articles 30, 35, 37 GDPR.
- Duty to examine the lawfulness of processing of personal data according to Articles 6 and 9 GDPR.
- Compliance with the provisions for declarations of consent according to Articles 7 and 8 GDPR.
- Transparent information of employees/customers on the data processing (with respect to customers and employees) according to Articles 13, 14 GDPR.
- Duty to delete data, which are no longer needed or whose storage is no longer admissible (Art. 17 GDPR).
- Duty to make data provided by customers/employees available– in a conventional format – to the customer/employee upon request (right to data portability) according to Art. 20 GDPR.
- Compliance with the provisions on data protection by design and data protection by default ("data protection through technical measures and data protection-friendly default settings") in respect to employees and in respect to customers according to Art. 25 GDPR.
- Compliance with the provisions in the case of outsourcing of data processing to a service provider and other processors according to Art. 28 GDPR, including the provisions on the transmission of data outside the EU or to subsidiary/sister companies.
- Obligation regarding data protection measures according to the state of the art according to Art. 32 GDPR.
- Reports of data outflows after an IT security incident according to Art. 33 GDPR.

Violations of nearly all of the above mentioned obligations are subject to fines in case of violation.

5. Broad Concept of "Personal Data"

According to the FDPA and the GDPR, personal data means any information relating to an identified or identifiable natural person, whereby the person might be identified directly or indirectly, in particular by reference to an identification number.

According to a judgement of the CJEU, even dynamic IP addresses must be considered personal data. For the avoidance of risks, nearly all information should be considered personal data (with the only exception of mere statistical information).

6. Permissibility of Data Processing

Processing or use of personal data is not permitted unless authorized by the FDPA, the GDPR or other statutory rules, in particular if the individual whose data is collected, processed or used (data subject) has given his/her consent.

Consent requires prior information about the circumstances of the data collection and its purpose. Instructions and consent should normally be in writing according to the FDPA. Exceptions apply where the written form would be unreasonable in the given circumstances, in particular in e-commerce. According to the GDPR, written form is no longer needed for a declaration of consent.

The FDPA and the GDPR authorizes data processing without the data subject's consent, in particular

- for purposes of the performance of a contract or a quasi-contractual fiduciary relationship maintained with the Data Subject,
- insofar as this is necessary to safeguard justified interests of the Data Collector and provided there is no reason to assume the Data Subject has an overriding legitimate interest that his/her data are not collected, processed or used,
- if the data are publicly accessible or if the Data Collector may lawfully publish the data, except if the Data Subject's legitimate interest overrides the justified interest of the Data Collector,
- where it is necessary to protect the legitimate interests of a third party,
- where it is necessary to avert threats to national or public security or for the investigation of a crime,
- for purposes of marketing, market research and opinion polling, in relation to data in list form or otherwise combined data on members of a given category of individuals.

Specific protection applies to special categories of sensitive personal data, such as data on racial and ethnic origin, political opinion, religious or philosophical beliefs, trade union membership, health or sexual orientation. Such data may not be processed on the basis of legitimate interest of a company.

7. Transfer of Data Abroad

Transfer of personal data abroad is permitted in accordance with the relevant EC Regulation. This means that transfer to other EU or EEA Member States is permitted under the same terms as a data transfer within Germany. The same applies to transfers to countries which provide a level of data protection that is comparable to EU standards. Transfer restrictions apply, regardless of whether the recipient is affiliated with the Data Collector contractually or by corporate law.

If data is transferred to a recipient in a country that is not located within the EU/EEA, and if that jurisdiction does not provide a comparable level of data protection, a transfer of personal data is permitted with (i) the Data Subject's consent or (ii) if the recipient is using contractual standard provisions provided by the European Commission, or (iii) upon consent by the relevant data protection authority.

8. Collection, Use or Procession or Use of Personal Data on Behalf of Others ("Commissioned Data Processing")

The FDPA and the GDPR require an explicit agreement between the data controller and any third party collecting, using or processing personal data on behalf of the data controller. Such agreement has to set out inter alia:

- the subject and duration of the work to be carried out,
- the extent, type and purpose of the intended collection, processing or use of data, the type of data and category of data subjects,
- the rectification, erasure and blocking of data,
- any right to enter into subcontracts,
- the controller's rights to monitor and the processor's corresponding obligations to accept and cooperate,
- the extent of the controller's authority to issue instructions to the processor,
- the return of data storage media and the erasure of data recorded by the processor after the work has been carried out.

The data controller is required to regularly exercise controlling measures to ensure that his/her contracting party complies with the obligations set out in such contract.

While the FDPA requires the written form for such an agreement on commissioned data processing, under the GDPR the electronic form (i.e., email) is sufficient.

9. Disclosure of Data for Due Diligence Purposes

In general, during the course of a due diligence process, a seller may disclose personal data (such as data of employees and management) for due diligence purposes in accordance with the principles outlined above. Since the interests of the disclosing party and of the Data Subjects must be respected, in the initial phase of due diligence, any personal data of management and key employees may be identified, as may the remainder of the employees, however, without disclosing their name. When a transaction during the course of a due diligence becomes more likely, all names and full employment contracts may be disclosed. Sensitive personal data shall not be disclosed, however, due to the fact that the employees interest in the non-disclosure usually prevail. In any case, confidentiality has to be agreed between the potential buyer and the potential seller.

10. Specific Provisions for Telecommunications Services and Telemedia Services

Telecommunications services providers may, within an existing customer relationship, use data of a subscriber's telephone number and postal (including electronic) address which they have lawfully obtained, for the transmission of text or picture messages for promoting their own business offers, provided the customer has been informed of his/her right to object to such uses and the customer has not objected.

Usage data collected for billing purposes must be deleted no later than six months after the provider has sent out the respective invoice and the user has not objected to this invoice.

11. Disclosure Obligation

A 2009 amendment to the FDPA requires companies to inform the relevant authorities about cases where personal data or bank-related data have leaked or where personal data were leaked under circumstances which constitute administrative or criminal offense.

Such notification obligations are further expanded under the GDPR.

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12. Registration Requirement

As a rule, private Data Collectors are required under the FDPA to notify the relevant supervisory authority prior to putting automated personal data processing procedures into operation. Significant exceptions apply, however:

(1) No registration is required if the FDPA does not apply (see above).
(2) No registration is required if the FDPA does not require the appointment of a Data Protection Officer or if a Data Protection Officer is appointed voluntarily without legal requirement.
(3) No registration is required, if (i) the collection, processing or use of the data is only for the own purposes of the Data Collector, (ii) not more than nine employees are involved in the collection, processing or use of the personal data and (iii) either the consent of the data subject has been obtained or (iv) the collection, processing or use is done for the sole purpose of furthering a contractual relationship or a quasi-contractual relationship with the data subject.

According to the GDPR, there is no obligation to register data processing with a competent authority.

XXVI. Media and Communications Regulation

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1. Constitutional and Regulatory Framework

The German Constitution (*Grundgesetz* – Basic Law) provides for freedom of opinion, freedom of information, freedom of press and freedom of broadcasting. These are fundamental rights binding the legislature, the executive and the judiciary as directly applicable law. In some cases, these rights also have a direct third-party effect meaning that they can influence the content of legal relationships under the civil laws.

As explained in the introductory remarks, the German federal structure is characterized by an allocation of certain legislative and governmental powers to the Federation (Bund) and others to the States (*Länder*), pursuant to Article 30 of the Basic Law. Consequently, the media and communication industry sectors are subject to two levels of legislation: broadcasting falls under Länder jurisdiction, the technical aspects of electronic communication, individual communication, data protection, general business law etc. fall under federal jurisdiction.

2. Telecommunications Law

a. Telecommunications Act

After various fundamental changes (from a mere administrative framework of Germany's PTT monopoly to a modern set of laws featuring liberalization and competition), the German Telecommunications Act in its latest version of 2016 *(Telekommunikationsgesetz – TKG)* implements the relevant European Directives and follows closely the EU regulatory approach. The TKG covers only the technical side of telecommunication, not its content. Its purpose is to guarantee the nationwide basic supply of services, innovative competition and user protection. The relevant regulatory body is the Federal Network Agency *(Bundesnetzagentur für Elektrizität, Gas, Telekommunikation, Post und Eisenbahnen – BNetzA)*. The BNetzA is an independent governmental authority with some regulatory power, seated in Bonn. It is internally structured into several sectors of competence. The instruments of the law are market regulation (particularly access

and remuneration), customer protection, frequency allocation and some tools regarding the transmission of digital broadcasting as well as numbering, universal services and the right of way, data and secret protection and public security. In addition to the TKG, a number of regulations *(Verordnungen)* deal with various details. Decisions of the BNetzA's ruling chambers can be appealed to the Cologne Administrative Court, which has exclusive jurisdiction and is the only instance to review the facts in dispute. The second appeal instance leading to the Federal Administrative Court of Justice in Berlin is reduced to legal review.

b. Telemedia Act (TMG)

The Telemedia Act in its latest version of 2016 *(Telemediengesetz – TMG)* provides the legal framework for a broad array of telemedia services excluding broadcasting activities and pure (technical) telecommunication services. Services falling within the scope of the TMG are e.g., E-commerce-portals, Internet access services, Video-on-demand or research services (Google). Live streaming or webcasting on the other hand are considered broadcasting and not covered. Telemedia services are not subject to any prior notification or license requirements. The TMG provides for certain specific rules with regard to customer information, liability for content and data privacy. Specifically, the TMG loosens the service provider's liability for external content to some degree.

Some content-related regulation for telemedia can be found in Chapter VI of the States Treaty on Broadcasting and Telemedia *(Rundfunkstaatsvertrag – RStV)*. Telemedia of "journalistic-editorial composition," i. e., of a certain, albeit not as high as "pure" broadcasting, capability of influencing public opinion, have to adhere to journalistic standards. Unlike "pure" broadcasting, these services do not require prior filing. Furthermore, the RStV provides certain rules for counter-statements, information privacy, advertising (duty to distinguish clearly between commercial and other content), prize competitions etc.

Due to the ever-changing character of services offered, it is not always easy to distinguish between telemedia and broadcasting. Still, the new broadcasting definition (see below) might make the distinction a bit easier. As a rule of thumb, telemedia services are either "non-linear" media services or "linear" media services with limited influence on public opinion. Nevertheless, ultimately the Länder media authorities will have the final say on the classification of a service as telemedia or broadcasting. If a media authority considers a certain activity to be broadcasting, the provider will either have to obtain a license or change the services within a period of three months in a way that its content does not meet the requirements laid down in the broadcasting definition of the treaty anymore. Likewise, there is a fine line between simply business-orientated telemedia and services with a "journalistic-editorial" composition, though the latter differentiation is not as important as both do not require a license.

c. Competition Law Aspects

Since most of the legal questions in the communication sectors have an impact on competition, the national cartel law and merger control play an important role. In 2005, the Act Against Restraints of Competition *(ARC, Gesetz gegen Wettbewerbsbeschränkungen – GWB)* has been harmonized to meet the principles of Articles 101, 102 TFEU. This made German national law more predictable for foreign parties operating in Germany. The relationship of the authority enforcing the GWB (the Federal Cartel Office, FCO, *Bundeskartellamt*) and the BNetzA, and the relationship of the substantive content of both laws, is governed by Section 123 TKG. A certain procedure of cooperation and mutual participation rights tries to avoid duplication of competence and contradictions in the application of the laws. Decisions of the FCO have to be challenged at *Düsseldorf Higher Regional Court (Oberlandesgericht)* followed by the second and last instance of the Federal Court of Justice *(Bundesgerichtshof)* in Karlsruhe.

3. Broadcasting Law

The fact that 16 German States *(Länder)* each have their own broadcasting laws is a curious anachronism in the age of global networks and continental

satellite coverage. Therefore, the Länder have decided to issue harmonized legal standards which apply throughout Germany, although stipulated in more or less 14 identical sets of Länder laws. Berlin and Brandenburg share one law and one media authority, as do Schleswig-Holstein and Hamburg; all other Länder have their own laws and authorities.

The Federal Constitutional Court *(Bundesverfassungsgericht – BVerfG)* has elaborated in a number of leading cases that the influence of broadcasting on the formation of the public opinion is so strong that State legislation has the right and the duty to regulate all broadcasting activities intensively. Joint standards are laid down in a States Treaty on Broadcasting and Telemedia *(Rundfunkstaatsvertrag – RStV)*. The current *RStV* implements the European "Audiovisual Media Services Directive" (AVMD) of 2007. As in the "Audiovisual Media Services Directive," broadcasting is now defined as a "linear" information and telecommunication service ("linear" being defined as: geared towards the general public as opposed to individual communications, technically being the simultaneous reception of visual or audio material transmitted by electromagnetic waves by the general public in accordance with a previously established schedule). Non-linear audiovisual media services do not fall within the scope of the *RStV* and are covered by the Telemedia Act. The same applies to linear audiovisual services with a limited audience, without journalistic-editorial composition and pay-per-view services.

The *RStV* includes regulations for public broadcasting companies, rules on licensing and control of private broadcasting companies and on advertisement. It also addresses the organization and activities of public broadcasters. Chapter V contains certain rules concerning platform providers. Finally, the States Treaty answers the question as to who is how entitled to use transmission capacity content-wise after the use is cleared on the *BNetzA* level, including ITU coordination. Broadcasting activities are regulated quite intensely. The same is true for the cable channel allocation which burdens cable network operators with far reaching must-carry rules, confirmed in a number of ECJ rulings.

Apart from the merger control rules of the *GWB*, the *RStV* provides for an additional ownership control administered by the Media Concentration Commission *(KEK – Kommission zur Ermittlung der Konzentration im Medienbereich)*. It becomes relevant in situations where a media company has an audience share of more than 30% and intends to merge with another broadcaster that is already present on the German market. Thus, mergers in the broadcasting sector are potentially subject to two cumulative merger control screenings: (1) the regular *GWB* Merger Control proceedings with, like in the press sector, significantly lowered merger control thresholds; (2) the special *RStV* proceedings with the special purpose of guaranteeing plurality of opinion. Further restrictions can be found in the relevant state laws. For example, the State Law on Media North Rhine-Westphalia *(Landesmediengesetz NRW – LMG NRW)* ties the acquisition of broadcasting services by a press company holding a dominant position to the provision of third-party access or similar measures to ensure diversity of opinion.

4. Press Law

Whereas the electronic media have significantly gained importance over the last decades, and have triggered the most interesting legal issues and conflicts, the press sector has remained quite stable. The Constitution allocates the competence for press law again to the Länder. The 16 Länder press laws are essentially similar and consistent, dealing with specific information rights, obligations of the press, raising the judicial thresholds for search and seizure, etc.

It is important to note that the merger control in the *GWB* provides for specific press rules regarding the calculation of revenue significantly lowering the merger control thresholds, therefore bringing more mergers under the scrutiny of the FCO. Further, the "de-minimis" rule does not apply additionally widening the scope of the German merger control regime. These rules are designed to prevent monopolies on a regional and local level.

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5. Impact of European Law

The media markets are markets within national boundaries insofar as the language of a German-speaking product naturally means that its meaning to parties outside the country is reduced. Foreign media using foreign languages have also a limited meaning on the German market. Globalization of modern communication means has led to a high degree of internationalization, however, and cross-border media participations are no longer the exception but the rule. European law, particularly the relevant directives and decisions of the Council and the Commission, as well as the case law of the European Court of Justice, increasingly impede the ability of national legislators to distinguish their systems from others within the European Union. The recent "Audiovisual Media Services Directive" had a decisive influence on German broadcasting law, fundamentally changing the German definition of broadcasting services, as shown above.

For 2017, it is expected that the AVMD will be completely renewed and – together with copyright legislation – opens legal barriers which were of relevance for IPTV and OTT (over-the-top) television. The new approach is to legislate all services on a technical-neutral basis and no longer to distinguish between classical distribution paths and the EU-wide internet. There is resistance, however, specifically among content producers and it remains to be seen whether or not this milestone for the internal market concept can be reached.

Also, the European Court of Human Rights in Strasbourg applying the European Convention of Human Rights (ECHR) often issues decisions which have a dramatic impact on the media laws in Member States of that Convention. A particular example is the Caroline of Monaco decision of the court in Strasbourg in 2005, which completely changed the traditional German doctrine of priority of the press freedom over the protection of privacy of celebrities. Although the ECHR has only the status of federal law by transposition into national German law, the BVerfG follows the interpretation of human and basic rights of the ECHR by the European Court of Human Rights in Strasbourg when applying German constitutional law of higher ranking.

XXVII. Employment and Labor Law

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German labor and employment law is contained in numerous single laws, interpreted and specified extensively by case law. The following brief outline of standard terms of employment, protective provisions, dismissal restrictions, works council and collective bargaining issues, as well as co-determination and social security aspects will provide some valuable background.

1. Terms of Employment

The employment contract is legally defined in Section § 611a of the German Civil Code *(Bürgerliches Gesetzbuch)*. According to this definition, an employee is not merely required to perform services, but to perform them subject to the authority of the employer.

Employment contracts need not be made in writing in order to become legally effective. The Documentation Act *(Nachweisgesetz)* requires, however, that the employer provides the employee with a document that outlines the essential employment terms. The parties normally sign a detailed employment contract which sets forth the terms and conditions in reasonable detail. Pursuant to Section 106 of the Industrial Code *(Gewerbeordnung)*, with respect to matters not specified in an oral or written employment contract, the employer has a comprehensive direction right regarding routine matters such as the working time, place of work and the job description. In the event of a dispute over the content and legal effects of such employer directives, either party may ask a labor court to review the fairness of the employer's instructions *(Billigkeitskontrolle)*.

2. Protective Provisions

a. Working Hours

The Working Time Act *(Arbeitszeitgesetz)* limits the daily working time to eight hours. An increase of the working time up to ten hours per workday is legally permitted, provided the average number of hours worked over a six-month period

does not exceed eight hours per workday. The stipulations of the Working Time Act are mandatory and cannot be contractually altered except where expressly permitted. There is no work permitted on Sundays and public holidays except with special permission of the relevant local authority or by law.

b. Vacation Entitlement

According to the Federal Vacation Act *(Bundesurlaubsgesetz)*, employees are entitled to a statutory vacation of a minimum of 24 workdays (the term workdays includes Saturdays). This corresponds to four weeks if the workdays of a given employment are from Monday to Saturday, and to 20 days if the employment is agreed on a five-workday basis.

c. Protection against Discrimination

The Equal Treatment Act *(Allgemeines Gleichbehandlungsgesetz)* prohibits discrimination due to race, ethnic origin, sex, religious and ideological beliefs, disability, age or sexual orientation. Different treatment of applicants and employees is justified if there are acceptable reasons. For instance, if a workplace is suitable only for a person without a given disability, the appropriate selection may be made. A differentiation in the amount of compensation in a social plan may be made with a view to the age of participating employees. The employer has to ensure that employees are protected from discrimination at the workplace – this includes protection against discriminative behavior by other employees. If the employer does not comply with the provisions of the Equal Treatment Act, the employee may have the right to refuse performance, and he or she may sue the employer for damages.

d. Data Protection

For applicable regulations regarding the treatment of personal data of the employees, see chapter XXV.

e. Rights of Pregnant Employees and Parental Leave

Pursuant to the Maternity Protection Act *(Mutterschutzgesetz)*, a termination notice concerning a pregnant employee is legally invalid (such protection extending to the end of a period of four months from childbirth), provided the employer knew about the pregnancy when issuing the termination notice, or if the employer is advised of the pregnancy or childbirth within two weeks from service of the termination notice. Such termination notices are, however, legally valid if, upon the employer's prior request, it was permitted by the relevant State authority for a special reason. The reasons may not be connected with the pregnancy. The notice must be given in writing and must state a permitted ground for the dismissal.

During a period of – normally – six weeks before childbirth and eight weeks thereafter, a female employee can claim maternity leave. Under the conditions of the Parental Allowance and Leave Law *(Bundeselterngeld- und Elternzeitgesetz)*, female as well as male employees are entitled to a maximum of three years (unpaid) parental leave up until the third birthday of each child. The employer may not terminate a parent during parental leave (except if permitted by the relevant State authority). Subject to the employer's consent, a parent may request that two of the three years of parental leave be granted at a later time before the eighth birthday of the child. During parental leave, the employee has the right to ask for part-time work with the employer.

f. Rights of Disabled Employees

Employees with certified disability of 50% or more can claim five extra days of vacation in each calendar year and can ask to be released from overtime work. After six consecutive months of employment, the termination of employment of a disabled employee by the employer is legally invalid unless consent is obtained from the relevant public authority, the Integration Office *(Integrationsamt)*. Before such a termination, also the Representative Council of Employees with Disabilities *(Schwerbehindertenvertretung)* needs to be heard for the termination to

be valid. The notice period is at least four weeks. These special regulations do not apply if at the time of notice the disability is not known or obvious and has not been proven to the employer. The special regulations apply, however, if the application to determine the disability has been filed at least three weeks prior to the notice and the disability status is granted subsequently. If an employment relationship has lasted for more than six months, the employee must disclose an existing disability if asked by the employer. If an employee fails to fulfill this obligation, he or she may not qualify for the special protection against dismissal.

g. Rights of Employees with Close Relatives in Need of Care

Employees whose close relatives are in need of care have special rights under the Time of Caring Act *(Pflegezeitgesetz)*. Section 2 para. 1 of the Time of Caring Act stipulates that an employee can claim to be released from work for up to ten days if one of his close relatives needs help to organize adequate medical care in an urgent situation. If an employee wants to care for a close relative himself or herself, i.e., at home, he/she has the right to be released from work for up to six months (Section 4 paragraph 1 of the Time of Caring Act). Whether in these two cases the employee will get continued remuneration depends on the compensation provisions of the Civil Code. The Time of Caring Act itself does not provide for the continuation of remuneration. During the time of organizing medical help or caring for a relative personally, an employee may not be dismissed. The employer may apply with the relevant state authority for a special authorization of such termination notice.

The Time of Family Caring Act grants certain financial benefits to employees accepting working time reductions and provides other assistance to employees who are involved in certain care for needy family members. Employees may, in certain circumstances, ask for a reduction of working hours down to fifteen hours a week for a maximum period of two years.

h. Sick Pay

After four weeks of employment with a given employer, employees are entitled to receive full sick pay from their employer for a period of six weeks in the case of illness or working accidents not caused by negligence (Continuation of Remuneration Act – *Entgeltfortzahlungsgesetz*). The six-week period starts with each onset of an illness that is due to an underlying condition, provided that either:

- six months have passed since the last sick leave, or
- one year has passed since the beginning of the first sick leave.

Once the six-week period has expired, the employee is entitled to receive sickness allowance from the statutory health insurance scheme.

i. Employee Deployment Act *(Arbeitnehmer-Entsendegesetz)* and Minimum Wage Act

According to the Employee Deployment Act, employment conditions negotiated by participating parties in a collective bargaining agreement regarding minimum wage, holiday entitlements as well as holiday allowance and the payment of an additional holiday allowance may be extended to all employment relationships of the same industry sector by means of a government declaration that declares such conditions generally binding, or by a statutory order. With this extension, the negotiated employment conditions apply for all employees of this industry sector in Germany. This rule applies only to industry sectors explicitly named in the Employee Deployment Act. Currently these are: Primary and secondary building industry, property cleaning industry, letter postal service industry, security service industry, special mining work in coal mines, laundry service for property clients industry, waste industry including street-cleaning and winter services, basic and advanced training service industry, nursing care industry, and slaughtering and meatpacking. The Employee Deployment Act provides for a special procedure with regard to the nursing industry. Accordingly, a stipulation of minimum wages and holiday regulations by statutory order is likewise possible.

The rule stated above may also apply to other sectors if it seems necessary in the public interest.

Since January 2015, there has been a Minimum Wage Act which applies to all employees, except for certain types of interns as well as apprentices, volunteers, minors and long term unemployed. At the moment, the minimum wage is €8.84 per hour but this amount is adjusted every two years, the next time in 2019.

Refusal to pay the minimum wage can be fined with up to €500,000.

3. Dismissals

a. General

The termination of an employment relationship by notice of the employer is governed by the Protection Against Unfair Dismissal Act *(Kündigungsschutzgesetz)*. It requires specific grounds to justify a termination notice if the terminated employee has been employed for at least six consecutive months. The Act is applicable to businesses employing more than ten (in some situations five) employees. Part-time employees do not participate in the headcount. Instead they are included by hours worked, i.e., up to 20 part time hours = 0.5 employees, up to 30 hours = 0.75 employees. When calculating the size of the company, temporary agency workers working in the company must be included if their use is based on a „generally" existing demand for manpower. Termination notices must be given in writing, with legal original signature of the employer or his authorized representative. If a works council exists, a termination notice is legally invalid if the works council has not been informed and heard prior to the termination notice. The basic statutory notice period is four weeks, terminating the employment at the fifteenth or the last day of a calendar month. Notice periods apply equally to notices of the employer and the employee. The length of the notice period to be observed by the employer increases with the duration of the employment, up to a maximum of seven months. If an extended notice period applies, the termination notice is effective only at the end of the relevant month at the end of the notice period. Collective bargaining agreements *(Tarifverträge)* and individual employment contracts often provide for notice periods that are longer than those prescribed by statute. Shorter periods may be agreed in certain exceptional cases. There is no right to pay in lieu of applying the applicable notice period. Unless agreed otherwise, the employee has not only the duty but also the right to work until the notice period has elapsed. If the employer prohibits the dismissed employee from working in order to protect business secrets, or if the employee finds himself/herself cut off from the opportunity to maintain his/her professional skills, disputes often arise over the right to work during the notice period (or even for the duration of a lawsuit over the validity of a termination notice). If the employee objects to the dismissal, he/she must file a complaint with the labor court within three weeks from receipt of notice of termination or else the employee will no longer be entitled to contest the notice in court.

b. Ordinary Termination

Employees have the right to terminate the employment contract without cause unless the parties have agreed on permissible termination limitations. The notice period must be observed, however.

An employer's termination notice is subject to certain validity conditions if the Protection Against Unfair Dismissal Act applies as described above.

Dismissals are only legally justified if they are based on reasons that relate to any of the following:

- the employee's individual circumstances (e.g., a long-term illness);
- the employee's conduct;
- economic, technical or operational (ETO) grounds that rule out the possibility for the employee continuing to work in the business.

The employer can base the termination on grounds related to individual circumstances of the employee, particularly certain illness conditions of the relevant

employee. A termination may be lawful if the employee is frequently ill for short periods (beyond certain acceptable sick leave durations), or if he or she is ill for a long term. In both cases, case law sets certain limitations which require a prognosis regarding the employee's future ability to work regularly.

Frequent short-term absences in the past (normally more than 30 working days p. a. in at least three consecutive years) allows the employer to assume there will be substantial absences in the future, causing an imbalance of rights of the parties. If this level of absenteeism has been reached, it is up to the employee to disprove the employer's negative prognosis. Frequent short-term absences in the past of up to 30 working days p. a. alone is normally not sufficient support of a negative prognosis.

In the case of a long-term illness, termination is likely justified, if

- there is a negative prognosis regarding the expected length of the illness;
- the long-term illness leads to considerable impairment of the employer's operational interests;
- there is an imbalance of interests to the detriment of the employer, the latter need not accept the impairment of its operational interests caused by the long-term illness.

Prior to the termination of the employment relationship due to a short-term or long-term illness, when the employee is ill a total of six weeks within a year, the employer is required to conduct corporate rehabilitation management *(betriebliches Eingliederungsmanagement)* in which the employee concerned, the employer, the works council and other representatives discuss the possibilities of a return to the workplace.

Cases where it will be impossible for the employee to perform his or her contractual duties, e.g., employees' imprisonment, fall within this category.

Personal conduct-related dismissals require culpable misbehavior or poor performance of the employee in violation of the employment agreement. Normally, a prior warning is required before a termination notice is permitted for a reason stated in the warning (letter). This does not apply if the employee must know that the behavior in dispute is unacceptable without a doubt (e.g., cases of serious criminal offenses to the detriment of the employer). If the employer suspects, based on specific facts, serious and gross violation of the employee's duties, the employer may terminate the employment after it has heard the employee, even if it cannot fully prove the misbehavior.

Unlike conduct-related dismissals or dismissals for personal reasons, the grounds for a dismissal on compelling ETO reasons are business-related and require an entrepreneurial decision by the employer. To qualify, the compelling business reason must meet the following requirements: it must eliminate the workplace of the employee in question (or of a comparable employee) at the latest as of the day of the expiration of the notice period. This could be due to external causes, such as a significant decrease in sales, a necessary rationalization, or the closing of (parts of) the enterprise, provided this internal cause finally leads to the elimination of workplaces. Financial considerations, such as reduction of overhead or payroll expenses, will not directly justify a termination. A business reason is "compelling" if and when the employment of the employee is no longer commercially justified and other means of preventing the dismissal, such as cuts in working time or in overtime, are not available.

A dismissal for compelling ETO reasons is not legally justified if the employee could be assigned to another position available within the employer's business. Finally, the employer must make a selection among several comparable employees under social aspects by screening comparable employees according to the following criteria: length of service, age, support/alimony obligations, severe disability. The employer must balance these criteria and select the employee who suffers the least hardship from a dismissal.

c. Dismissal without Prior Notice

An extraordinary dismissal without prior notice (termination for severe cause) terminates the employment with immediate effect, Section 626 of the Civil Code *(Bürgerliches Gesetzbuch)*. An extraordinary dismissal requires circumstances which, taking the entire situation of the individual case into account and weighing the interests of both parties, render it unreasonable for the employer to continue the employment relationship until the notice period has elapsed.

d. Mass Dismissals

In the case of mass dismissals, the employer is obliged to notify the Federal Employment Agency *(Bundesagentur für Arbeit)* in writing about the intended dismissals before notices are given or termination agreements signed.

e. Fixed-Term Employment Contracts

According to the Part-Time and Fixed-Term Employment Act *(Teilzeit- und Befristungsgesetz)*, employment contracts can be concluded for a fixed period of time, provided the limitation has been agreed in writing before it commences (original signatures of both parties on the identical document are required).

Fixed-term contracts are legally permitted if there is a specific justification for limiting the employment term (because the legislator favors the conclusion of unlimited contracts). Only in cases where the employer employs the employee for the first time, no justification is required if the limited term does not exceed two years (up to three limited terms are permitted within such two-year period). This rule also applies if a prior employment has ended more than three years before the limited term employment starts. An apprenticeship is not regarded as a prior employment.

f. Effects of Business Ownership Transfers

Dismissals connected with a business ownership transfer (Section 613a of the Civil Code) are legally invalid, unless the dismissal is particularly justified, e.g., for compelling ETO reasons.

Section 613a of the Civil Code applies to the ownership transfer of a business or of a part of a business. Business is defined as a "long-term economic unit." A part of a business is defined as an organizational subdivision of a business which itself qualifies as an economic unit. To qualify as a business in this sense, the transferred assets must represent a certain business identity (continuation of such identifiable business operation by the new employer) in terms of a given character of the business, its assets (including intangible assets such as customer lists, know-how, etc.), the transfer of the workforce, the customer base, the degree of similarity between the activities carried out before and after the ownership transfer, and the duration of any interruption of the business activity prior to the transfer.

4. Works Council

A works council *(Betriebsrat)* is the employees' representative body; it can be elected in all offices or works with regularly five or more permanent employees. The rights and obligations of the works council are laid down in the Works Council Constitution Act *(Betriebsverfassungsgesetz)*. If more than one works council exists at different locations of a business, these have to form a Central Works Council *(Gesamtbetriebsrat)* which is then competent for all co-determination matters which require uniform regulation in at least two offices or factories of the business relating to all sites of the company. A General Works Council *(Konzernbetriebsrat)* of affiliated businesses may be formed if more than one Central or Single Works Council exists. It is competent for all co-determination matters which need uniform regulation in at least two affiliated companies within the group of companies. Depending on the issue, the works council's

rights vary from a mere information right to a consultation right, up to the right of co-determination. In some cases, the consent of the works council is even required before a given measure may be implemented. In addition, the works council may conclude agreements with the employers, which create rights and obligations between the employees and the employer.

Members of the works council are released from the obligation to work to the extent needed. In plants or offices of at least 200 employees, one member of the works council is permanently released from the obligation to perform the work of his or her employment contract.

Works council members are protected against termination of their employment during their term and for a year after their respective term unless the plants or offices are permanently shut down (Section 15, Paragraph 1 of the Protection Against Unfair Dismissals Act). Even a termination without prior notice (for a severe cause) requires the prior consent of the works council, if not replaced by a court order.

If plants or offices with more than 20 employees (including temporary agency workers hired for more than three months) undergo essential operational changes *(Betriebsänderung)*, Section 111 of the Works Council Constitution Act provides for an obligation of the employer to inform and consult with the works council in good time prior to such change so that the works council is able to make suggestions of its own and exercise influence on management's final decisions. Essential operational changes that require observation of the works council's rights include:

- reductions in, or closure of, the entire operation or significant parts thereof;
- the transfer of the entire operation or significant parts thereof;
- a merger with other operations or the spin-off of operations;
- basic changes in the operation's organization, in its purpose, in the operating plant/equipment; or
- the introduction of fundamentally new work methods and production processes, provided such changes in operation result in significant disadvantages for the employees or considerable parts thereof.

The works council and management must try to reach a reconciliation of interests *(Interessenausgleich)*. If the parties are unable to reach agreement at the end of the consultation process (including an attempt to reach an agreement before a conciliation board presided by an independent chairman), management is free to proceed in accordance with its plans. Regarding any economic disadvantages for the employees, the works council may ask for a social plan *(Sozialplan)* which defines the compensation the employees are entitled to receive to balance such disadvantages. The compensation may include severance payments, job training, reimbursement of extra expenses, etc. Unlike the conciliation board proceedings concerning the reconciliation of interests, the social plan can be determined by decision of the conciliation board's chairman if the parties do not reach an agreement. Employers failing to attempt to achieve a reconciliation of interests (compensation) face court actions filed by the affected employees. In addition, some courts grant preliminary injunctions to enjoin the employer from implementing intended measures before the reconciliation of interests procedure is completed.

5. Collective Bargaining Agreements

In addition to works agreements between the employer and the works council, unions may ask for collective bargaining agreements, either with individual employers or with employers' associations.

The German Constitution guarantees the right to form, and become a member of, a union or of an employers' association, as well as the right to stay independent of such employee or employer organizations. Agreements limiting or hindering these rights are null and void.

Collective bargaining agreements serve a peacekeeping function. As long as an agreement on a given issue is in force, labor disputes and further claims on these issues are not permitted.

6. Corporate Co-Determination

Apart from the works council's right of co-determination (which aims at the employment organization), there is co-determination on the corporate level which relates to the functions of the supervisory board to monitor the management of a company. This applies to companies with more than 500 employees. Regarding Limited Liability Companies, stock corporations or partnerships limited by shares, which have 501 to 2000 employees, the One-Third-Participation Act *(Drittelbeteiligungsgesetz)* applies, meaning one third of the members of the executive board are representatives of the employees. If 2001 employees or more are employed, according to the Co-Determination Act *(Mitbestimmungsgesetz)*, the supervisory board consists equally of representatives of the shareholders and of the employees. The chairman is normally appointed by the shareholders.

The Coal and Steel Co-Determination Act *(Montanmitbestimmungsgesetz)* is applicable to companies in the coal mining, iron and steel industries with at least 1001 employees.

Since January 1, 2016, there has been a gender quota for publicly owned companies with co-determination under the Coal and Steel Co-Determination Act and the Co-Determination Act of 1976. In stock corporations the supervisory board must consist of at least 30% women and 30% men. It does not matter, whether these 30% consists of shareholders or employees.

7. Social Security and Income Tax

The statutory German social security system applies to employees and most general managers of a limited liability company (GmbH). It does not apply to self-employed individuals (freelancers) and members of the boards of stock corporations. Social security insurance covers five principal areas:

- Health *(Krankenversicherung)*, total premium is 14.6% of the gross salary;
- Pension *(Rentenversicherung)*, total premium is 18.70% of the gross salary;
- Unemployment *(Arbeitslosenversicherung)*, total premium is 3.0% of the gross salary;
- Nursing Care *(Pflegeversicherung)*, total premium is 2.55% of the gross salary and 2.8% if the employee is childless, born after December 31, 1939 and at least 23 years old;
- Accident *(Unfallversicherung)* costs are borne by the employers, subject to contribution rates, which change annually.

In general, the premium/contributions are payable by the employer and the employee at the rate of one half each (fifty-fifty). The amount of the contribution is a percentage of gross income (up to certain income limits). Employee contributions (like income and other taxes) are withheld and forwarded by the employer, together with its own share, to the relevant organization.

Unlike the situation in some other jurisdictions, company pension schemes are not mandatory. If they exist, they vary from being completely employee-funded schemes to those funded only by the employer. If claims of employees exist under a given company pension scheme, these are legally protected under the Company Pension Act *(Gesetz zur Verbesserung der betrieblichen Altersversorgung)*. There are tax reliefs available on contributions to company pension schemes.

Useful links:
- www.arbeitsrecht.de
- www.arbeitsrecht.org
- www.bmas.de

XXVIII. General Terms and Conditions, Consumer Protection

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As a consequence of EU Directive on Consumer Rights (2011/83/EU), effective as of June 13, 2014, the German Civil Code has been amended, improving once again the rules on consumer protection.

The German Act on General Terms and Conditions was adopted in 1977 to supplement the German Civil Code in respect of general terms and conditions used in business-to-business (B2B) and consumer-to-consumer (C2C) relationships. As amended to date, however, the statutory provisions mainly affect business-to-consumer (B2C) relationships. The changes have been the biggest stride towards consumer protection the legislature has made ever since.

The law aims at avoiding disadvantageous contract terms in situations where the consumer has no choice but to accept the terms presented by the business counterpart. This is often the case if the consumer faces pre-formulated General Terms and Conditions, the so-called "small print" which is often found on the back of order forms or order confirmations. These terms intend to accomplish mainly three aims: to rationalize, to close "gaps" in statutory law, and to shift or balance the risks connected with a contract relationship. Terms and conditions are often formulated in a one-sided manner and neglect consumer interests, however. The consumer usually has no choice other than to accept the imposed General Terms and Conditions.

In order to strengthen consumers' position, the Act on General Terms and Conditions created in 1979 a legal basis for the courts to control the content and handling of General Terms and Conditions. Since then, the validity of provisions used in Standard Terms and Conditions has been under constant judicial review.

Ambiguous, surprising or fundamentally unfair clauses have been held null and void. Invalid provisions are replaced by the corresponding statutory rule.

In 2002, the Act was incorporated into the German Civil Code, along with further consumer protection regulations such as the Act on General Terms and Conditions and Consumer Protection concerning Consumer Credits *(Verbraucherkreditgesetz)*, the Act Concerning Revocation Rights in Contracts Concluded at Home and Similar Dealings *(Haustürwiderrufsgesetz)*, and the Law Concerning Distance Selling *(Fernabsatzgesetz)*. These supplements were necessary in order to meet the requirements of several EU Directives, particularly the Directives on Injunctions for the Protection of Consumers' Interests (98/27/EC), on Distance Selling (97/17/EC), on certain Aspects of the Sale and Supply of Goods to Consumers and Associated Guarantees (1999/44/EC), and the Directive on Electronic Commerce (2000/31/EC). In June 2014, the Consumer Rights Directive (2011/83/EU) has been implemented Europe-wide. Together, these provisions constitute a self-contained system that ensures effective consumer protection.

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The German Act on General Terms and Conditions, as adopted into the German Civil Code, contains a general clause (§ 307 German Civil Code) and a catalogue of defined forbidden clauses. Furthermore, certain contract-related principles are applicable. These principles determine, among other things, the legal conditions under which General Terms and Conditions can become part of a contract.

Due to the Directive on Unfair Terms in Consumer Contracts (93/13/EC), the courts in EU Member States are required to interpret the rules of General Terms and Conditions in B2C contracts in compliance with EU law. Although not all German provisions on General Terms and Conditions apply to contracts between businesses (B2B relations), the general clause of § 307 German Civil Code and the provisions on surprising and ambiguous clauses, e.g., have to be considered in any event. Breaches against these provisions can be asserted as unfair competition (§ 4 No. 11 UWG) by competitors, certain industry organizations and consumer protection associations.

Further important regulations affecting consumer protection are:

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1. Law Concerning Actions to Cease and Desist

The Law Concerning Actions to Cease and Desist, adopted in 2002, provides for the right to claim cease and desist of illegal business behavior. It enables German as well as EU-based consumer protection associations to bring actions before German courts against parties who are using invalid General Terms and Conditions. The law is based on the Directive on Injunctions for the Protection of Consumers' Interests (98/27/EC). Further rules adopted into the German Civil Code provide protection for certain groups of consumers.

2. Law Concerning Distance Selling

Based on EC Directive 97/17/EC on Distance Selling, the German Act extends consumer protection to contracts made by distant parties. If a contract is not agreed upon face-to-face, but by means of, e.g., telephone marketing, infomercials or the Internet, the business offering a service will have to meet several information and disclosure obligations. Failure in meeting these requirements entails certain consumer revocation rights.

3. Law Concerning Consumer Credits

The Law Concerning Consumer Credits regulates consumer loans such as bank loans, financed purchases and other consumer lending situations.

4. Law Concerning Revocations of Contracts Concluded at Home and Similar Dealings

This law aims at the protection of consumers in situations in which a purchase of goods or services is offered at his or her home. The law provides for the right to revoke such agreements under certain conditions. This privilege expires after a defined period, however, during which appropriate instructions and disclosures must have been given to the consumer. If impeccable instructions and disclosures are missing, the revocation right will persist, thereby causing the risk that a contract remains revocable. In-depth review and knowledge of the relevant provisions is recommended.

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5. Directive on Consumer Rights (2011/83/EU)

Due to the new Directive on Consumer Rights (2011/83/EU), the German Civil Code was amended once again. Some changes will change business practices noticeably. The new regulations "Principles of Consumer Contracts and Special Forms of Distribution" have come into effect on June 13, 2014.

The law contains special provisions for contracts concluded outside of business premises and Distance Selling Agreements *(Fernabsatzverträge)*. According to the new regulations, dealings at any location that is not a business premise are subject to these special provisions.

As a further significant difference, contracts initiated by a consumer are now also subject to these protective rules. Until then, only contracts initiated by a business were covered.

Some provisions apply to E-Commerce. They cover, e.g., the "Button Solution" that had already been implemented into the German Civil Code. The "Button Solution" requires that the main features of the purchase order are visibly summarized before the consumer places the order with binding effect. Further, a contract is concluded only if the consumer clicks a button which reads "Buy Now" or a similar wording.

Further, new provisions concerning the revocation right must be considered within the scope of distance selling and contracts concluded outside of business premises.

XXIX. Purchase Law, CISG, Conflict of Laws (International Private Law)

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Purchase Law is one of the core elements of the German Civil Code (BGB). In order to provide an up-to-date and suitable statutory framework for its users, the BGB has undergone several alterations during the last decades. The most important of the recent reforms led to a modified law of obligations, which came into force on January 1, 2002. In the course of this revision, the legislator also modernized the purchase law.

1. German Purchase Law

The central provision of German Purchase Law is Section 433 BGB. Therein, the mutual obligations of the parties of a sales contract are stipulated, i.e., the seller is to transfer the goods agreed upon and ownership thereof to the buyer whereas the buyer in return is to pay the agreed purchase price to the seller.

a. Seller's Duties and Liabilities

In order to avoid warranty claims of the buyer, purchased (and transferred) goods must be free of defects. One reason purchased goods may be considered defective is if they do not have the quality agreed upon in the contract at the time of their delivery. If no agreement was made on specific qualities, the goods are deemed to be in line with the contract if they can be used for their contractual or customary purpose and thus meet the buyer's reasonable expectations.

Delivery of defective goods is deemed a breach of contract and triggers the buyer's statutory remedies. In such cases, the buyer may claim supplementary performance within a reasonable period from the seller (Section 439 BGB). This claim takes precedence over other remedies available to the buyer (Vorrang der Nacherfüllung); the buyer, at his or her discretion, may demand that the delivered goods be either repaired or replaced, whereby the seller bears all costs of this supplementary performance, in particular transport, work- men's travel, labor and materials costs. The seller is free from this obligation of supplementary performance only in cases in which it would not be suitable as a remedy or is impossible.

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If the seller fails to fulfill the buyer's claim for supplementary performance or performance is excluded due to one of the above exceptions, the buyer is entitled to either claim a price reduction (Section 441 BGB) from the seller or withdraw from the contract (Sections 440, 323 para. 2 BGB). Withdrawal leads to reversal of the sales contract, so that both parties are obligated to return performance already exchanged, e.g., goods, purchase price.

Where the seller has failed to perform or performance was incomplete or delayed, the buyer may be entitled to compensation for damages. The buyer must be able to show in any such case that damage or futile expenses were incurred due to the defect of the purchased goods, either because the seller did not perform after expiry of a time limit, the supplementary performance failed or the buyer suffered losses due to a delay in performance. The seller may only avoid this liability if he/she can prove that it was not responsible for the breach of contract. In some cases, the buyer may be able to show that he/she suffered damage to other interests protected under law due to the defect of the purchased goods. Here, the setting of a time limit for supplementary performance is not required.

In most cases, the limitation period for all of these remedies is two years, beginning with delivery of the purchased goods. If the seller has maliciously concealed the defect, the limitation period is three years. If the seller is a merchant who purchased the defective goods from another merchant before reselling them to the end user, then – with the exception of rules under the Product Liability Act (see chapter XXX) – the end user may only hold the final seller liable. Sections 478 et seqq. BGB, however, provide the seller with recourse against the first merchant, derogating from strict application of the above limitation periods.

b. Buyer's Obligations

The buyer must pay the contractual purchase price to the seller in the proper way (e.g., cash or by bank transfer), within the proper time limits and at the proper place. All this may be agreed upon in the contract. If the buyer fails to pay, the seller may stipulate a time limit for payment and, once this period has

expired without response, may withdraw from the contract or claim compensation for late payment.

c. Guarantee

In cases in which the seller or a third party (e.g., the manufacturer) has guaranteed certain qualities of the purchased goods and the goods do not display the guaranteed quality or durability, the buyer has certain other remedies in addition to those mentioned above. It is irrelevant when the defect appears in such cases, as long as it has arisen during the guarantee period.

d. General Terms and Conditions and Consumer Sales Directive

Some of the obligations and liabilities described above (e.g., the system of remedies) may be modified to the buyer's detriment by way of the seller's General Terms and Conditions (see chapter XXVIII). The EC Consumer Sales Directive dated May 25, 1999 (1999/44/EC) stipulates, however, that this does not apply to contracts for purchase of goods between a merchant and a consumer. Under the Directive, it is assumed that a defect was already present at the time of delivery if the defect appears within six months after the purchased goods were handed over to the consumer. This is a clear benefit to the consumer because the burden of proof is shifted from the consumer to the merchant.

e. Commercial Purchase

Trade between businesses is governed by specific rules set out in the German Commercial Code (HGB), which modifies some of the above-mentioned rules for the purchase of goods. One of the main differences is that a business has a certain obligation to examine goods upon receipt and to immediately notify the seller in the event a defect is identified; if the buyer fails to do so, he/she loses the possibility of recourse against the seller, except in cases in which the seller has maliciously concealed the defect.

2. Cross-Border Contracts

Foreign companies trading with German companies or consumers should consider that the law governing their sales contract is either subject to internationally applicable uniform rules for the sale of goods or subject to the applicable national rules for conflict of laws. Depending on the case, these legal sources may lead to the application of a foreign jurisdiction.

a. CISG

At present, the United Nations Convention on Contracts for the International Sale of Goods dated April 11, 1980 (CISG) is the only relevant regime of worldwide uniform rules concerning cross-border sale of goods, exempting the sale of goods bought for personal, family or household use. To date, the CISG entered into force in 85 countries all over the world, making it one of the most successful international uniform laws. It is automatically applicable for commercial contracts between enterprises having their places of business in different Contracting States and avoids recourse to national conflict of laws rules. Moreover, the CISG governs sales contracts in cases in which the applicable conflict of laws rules indicate the law of a Contracting State as the applicable one. Finally, the CISG may become applicable by virtue of the contractual parties' choice, regardless of whether their places of business are located in a Contracting State or not. In particular, it may be chosen if a "neutral regime" is needed as a compromise between divergent jurisdictions.

The CISG provides a careful balance between the buyer's and the seller's interests. It sets out rules regarding the formation of the contract and the mutual obligations of the parties, such as delivery of the goods and documents, payment of the purchase price and taking delivery of the goods. It also encompasses rules regarding risk transfer, remedies for breach of contract, damages and exemption from performance of the contract. It is possible for the parties to amend or derogate from the application of most of the CISG's provisions, e.g.,

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by applying their own General Terms and Conditions, which makes the regime even more attractive to contracting parties.

b. Rome I Regulation

If a sales contract does not fall under the scope of the CISG or if the parties exercise their discretion to opt out of the CISG, the rules to determine the applicable law in cross-border contracts are provided by the Rome I Regulation (593/2008/EC).

The Rome I Regulation is directly applicable in all EU Member States, including Germany. Under the Rome I Regulation, parties of a cross-border sales contract may at their discretion stipulate what regime will govern their contract. Any regime indicated by the parties will apply, whether it is that of an EU Member State or not.

In the absence of an explicit or tacit choice of law by the parties, the applicable law is determined by the Rome I Regulation and will usually be that of the seller's domicile. This would mean for instance that German law will govern a sales contract if the seller has its place of business in Germany, and Japanese law would apply if the seller has its domicile in Japan. Only in exceptional cases does the Rome I Regulation allow for a modification of this rule.

One of the aims of the Rome I Regulation is to safeguard consumers entering into contracts with foreign companies, so that the consumers can rely on the statutory rights they are used to in their home jurisdiction. It is for this reason that also parties to B2C contracts are free to stipulate the legal regime of their contract. Their choice of law will not prevail, however, if the laws of the chosen regime do not meet the consumer protection standards in the country of the consumer's habitual residence. Due to a recent decision of the European Court of Justice (July 28, 2016, C-191/15), foreign companies must even inform consumers about this restriction if they intend to incorporate their standard business terms into a contract with a consumer.

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Where no choice of law was made or the choice was invalid, the laws of the consumer's domicile may also govern B2C contracts if the company pursues commercial activities in that country or directs such activities toward that country and the respective sales contract falls within the scope of such activities.

The Rome I Regulation also sets out rules for determining whether there was contractual consent between the parties, the material and formal validity of a (sales) contract, the assignment of claims and the possibilities for the offsetting of claims.

Useful links:

- www.globalsaleslaw.org
- www.europa.eu/legislation_summaries/justice_freedom_security/judicial_cooperation_in_civil_matters/ jl0006_en.htm
- www.gesetze-im-internet.de/englisch_bgb/

XXX. Liability and Product Liability

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German law distinguishes between contractual liability, extra-contractual liability (tort), product liability and special liability based on potentially dangerous products or activities. As Germany has a civil law system, all forms of liability are based on specific statutes – there is no general liability based on common law principles.

1. Contractual Liability

As the term indicates, contractual liability requires a contractual or at least "quasi-contractual" relationship between the parties involved. Exempt from the following overview are contractual claims resulting from non-performance or mal-performance of a contract in the sense of (express or implied) warranty or performance claims (such as repair, exchange of defective products, etc.).

The central norms relating to liability in contractual relationships are § 280 – 285 of the German Civil Code *(Bürgerliches Gesetzbuch – BGB)*. In broad terms, § 280 (1) *BGB* requires that anyone who fails to comply with his obligations in a contractual relationship is obliged to compensate the injured party's damage. This reflects an important aspect common for most liability claims in Germany: "Damages" means exact or assessed compensation of the actual and/or foreseeable, financial damage inflicted – not less, but, in particular, not more. Hence, "special damages" or "punitive damages" are unknown under German laws. Another important principle is contained in § 280 (2) *BGB*: no damages without fault, either in the form of intent or in the form of negligence. § 281 – 285 *BGB* establish damages for non-performance (in lieu of performance), mal-performance (in lieu of performance of the remaining contractual obligations), inability or impossibility of performance, and compensation for expenses made in anticipation of performance that later failed.

These principles are refined and to a certain extent varied in the various norms relating to purchase contracts (§ 437 No. 3 and § 440 *BGB*) and goods (including buildings) made to order (§ 634 no. 4 *BGB*). The concept of liability described in the preceding paragraph does, however, remain unchanged. An important principle is contained in § 276 *BGB*: Liability cannot be waived beforehand for intentional acts. A contractual limitation of liability limited to gross negligence may be enforceable if contained in specific, individual B2B agreements (not with consumers), but may nevertheless fail if the agreement qualifies as "standard terms" in the meaning of the extremely broad concept presently applied to this term. Another principle is laid down in § 444 *BGB*: Any contractual waiver of liability (and purchaser's other rights) is null and void in a purchase contract if the seller deceived the purchaser or if it gave an express warranty. As consumers enjoy enhanced protection, waivers of liability in a contract with consumers are enforceable only to a limited extent. If such waiver is attempted by standard terms, the scope of permissible waivers is even narrower. It should be noted that the issue of standard terms – not only when addressed at consumers – is highly complex, subject to a constant flow of Federal Court of Justice rulings and, therefore, always requires specialized advice.

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2. Extra-Contractual Liability (Tort)

The central norms regarding tort are § 823 (1) and (2) *BGB*, which have a different scope: Under § 823 (1) *BGB*, anyone is subject to damages who harms someone else's life, body, health, liberty, property or "other rights." Most importantly, this provision does not protect a person's or an entity's financial status as such. This limitation does not apply within the scope of § 823 (2) *BGB*, which, however, in turn requires that the damaging act also violates "norms that protect others." Another form of tort is the damage to financial reputation (§ 824 *BGB*) and the (general) malicious damage to others (§ 826 *BGB*), which both also cover damage to a person's or an entity's finances.

The two other principles explained above apply only with certain variations: No liability without fault is the rule, but with a narrower scope for damage inflicted by buildings or animals. In addition to the remedy of actual damage inflicted, tort may qualify for compensation of pain and suffering. Such compensation is, however, usually significantly lower than in most other countries, most notably when compared with the U.S.

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In certain cases and to a limited extent, claims based on tort can exist alongside contractual liability claims. This is particularly important where the statutory warranty period has expired or where a defective product causes additional damage to other goods.

3. Product Liability

Germany's Act on Product Liability *(Produkthaftungsgesetz – ProdHG)* is the result of a corresponding EC Directive of 1985. The Directive has set similar standards of product liability for all Member States of the European Union, with fairly marginal differences between them. Most importantly, the *ProdHG* does not provide for damages for pain and suffering or punitive damages. The former can only be subject to a possible additional tort liability.

The *ProdHG* establishes a right to damages for damage inflicted by a defective product causing harm to life, body, health and property (limited, however, to "private" property, e.g., not for property used for business purposes), irrespective of fault. It extends the liability to the manufacturer. This includes the person or entity holding itself out as manufacturer and the importer (into the EU) in case the manufacturer cannot be identified. Certain restrictions apply: Liability is exempted if the product was not faulty at the time of marketing, if the product was not intended for sale or similar commercial use, if the product complied with mandatory laws, or if the fault could not be recognized based on the state of art at the time it was put on the market.

The amount of damages for damage to life and health caused by one product or by products with the same fault is limited to €85 million. This also applies if several persons are harmed, who, thus, only receive a quota. For harm to property, an amount up to €500 is exempted from the damages. A waiver of damages under the *ProdHG* is not possible.

4. Special Liability

As in most countries, specific laws relating to damages based on potentially dangerous products or activities exist. Such laws cover the operation of nuclear facilities, aircraft and plants with environmental danger potential, to name just a few. Most of these laws share basic principles with the *ProdHG* – most importantly, they do not require fault and contain a limitation of liability.

Individual norms establishing a right to damages also exist in laws regarding intellectual property, such as the trademark, patents and copyright acts, and in numerous other laws. These norms generally relate to tort, and are, thus, similar to the laws outlined above under paragraph 2.

Useful link: · www.foerderland.de/701.0.html

XXXI. Transport and Shipping Law

1. International Conventions

As far as international transport business is concerned, German transport law is dominated by various international conventions. International road transport is governed by the Convention on the Contract for the International Carriage of Goods by Road (CMR). As for international air transport, Germany has signed the Warsaw Convention of 1929 including the amendment of The Hague 1955 and the Guadalajara Convention of 1961. Since June 28, 2004, international air transport law in Germany has been dominated by the 1999 Montreal Convention on International Carriage by Air. The Montreal Convention prevails over the Warsaw Convention if the states of both contracting parties are members of the Montreal Convention. The international transport on inland waterways is governed by the Budapest Convention on the Contract for the Carriage of Goods by Inland Waterways (CMNI). As for maritime transport, the Hague Rules, as amended by the Brussels Protocol 1968 (Hague-Visby-Rules), and the Hamburg Rules 1978 have not been ratified. Major parts of the Hague-Visby-Rules have been adopted by national law, however. Separate conventions apply to the transport of dangerous goods.

2. Applicable National Law

To the extent international conventions do not apply, transportation by land, by aircraft and by inland waterways is governed by Sections 407 to 466 of the German Commercial Code. The German Commercial Code provides rules for the carrier business (Sections 407 to 452 d) and the forwarding business (Sections 453 to 466). A freight agreement obliges the carrier to transport the goods to the place of destination and to deliver them to the consignee (Section 407). Contrary to that, the forwarding agent is not obligated to execute but to handle the transport (Section 453). This includes the organization of the transport and the execution of other services agreed upon and related to transportation. The distinction between a carrier and a forwarding agent can be difficult from time to time and depends on the details of the case.

Sea transport – further reference to which will not be made – is covered by sections 476 to 619 of the German Commercial Code.

It is common practice of carriers and forwarding agents in Germany to use the German Forwarding Agents' Standard Terms and Conditions *(Allgemeine Deutsche Spediteurbedingungen – ADSp)*. These general terms and conditions have been developed by the Chambers of Commerce and various other commerce and transport-related organizations. The latest version of the ADSp has been agreed upon in 2017. The new ADSp have increased the liability of carriers and forwarding agents. The maximum liability for damage to goods has been increased from €5/kg gross weight of the consignment to 8.33 special drawing rights (SDR) per kilogram which equals around €10.49/kg [1 SDR = €1.25886 (April 24, 2017)]. The absolute limit of liability for damage to goods amounts to €1.25 million or 2 SDR/kg, whichever is higher. Although ADSp are widely accepted and incorporated in most of the contracts on carriage, the former practice to incorporate the ADSp implicitly is disputed. The Federal Court of Justice requires that the contracting partner must be informed in a qualified way, if liability-limiting ADSp conditions shall become integral part of the contract of carriage.

3. Particularities of German Transport Law

German transport law has a concept of "no fault" liability. The carrier is liable for damage arising from a loss of or damage to the goods from the time of their acceptance for transport until their delivery, or from the exceeding of the term for delivery. According to Section 426 of the German Commercial Code, the carrier is exempted from liability only if it was impossible to avoid the loss, damage or delay, even if utmost care was used. This, however, does not apply, if the loss, damage or delay is attributable to one of the risks listed in Section

427 of the German Commercial Code, including, inter alia, inadequate packing and insufficient labeling of freight pieces by the shipper. If damage has occurred which could arise from one of the risks listed in section 427 German Commercial Code, it is assumed that the damage has resulted from this risk. Therefore, the carrier is exempted from liability, unless the shipper is able to prove that the damage has not arisen from this risk.

According to applicable international conventions, to the German Commercial Code and under the ADSp, the liability of the carrier for loss and damage is limited depending on the weight of the shipped goods. Liability amounts vary depending on the applicable rules. Under section 431 of the German Commercial Code, the carrier's liability is limited to 8.33 special drawing rights (SDR) per kilogram of the gross weight of the goods. Apart from that, the carrier is not obligated to compensate any further damage except the freight charges, public levies and other costs incurred in connection with the transport. The liability for delay of delivery is limited to an amount equal to three times the freight charges. The liability for damage not arising out of a loss or damage to the goods or exceeding of the term for delivery is limited to three times the amount to be paid in case of the loss of the goods.

In case of willful or reckless conduct of the carrier, all applicable regulations – with the exception of the Montreal Convention – stipulate an unlimited liability of the carrier. The prevailing opinion interprets reckless conduct under section 435 of the German Commercial Code as gross negligence. An important case of reckless conduct and a specialty of German transport law is the concept of organization-related negligence, which has been developed by the German Federal Court of Justice. The Federal Court expects from a prudent carrier, inter alia, to control the entry and exit of goods within its premises. In case of a transport loss or damage, the carrier is expected to provide sufficient information on the circumstances of the loss or damage. If it fails to comply, it is refutably assumed that the loss or damage has been caused by organization-related negligence, which leads to unlimited liability of the carrier. The shipper's failure to declare the value of a shipment or to inform about the danger of an exceptionally high damage can constitute contributory negligence by the shipper.

Like the carrier, the forwarding agent is liable for damage to goods resulting from loss or damage while the goods are in his custody unless liability is exempted according to Sections 426 and 427 of the German Commercial Code (Section 461 para 1). With the exception of willful intent and reckless conduct, the forwarding agent's liability for loss of or damage to goods is limited to 8.33 special drawing rights (SDR) per kilogram of the gross weight of the goods (Sections 461, 431, 435). For damage not arising from loss of or damage to goods in his custody but from a culpable violation of the forwarding agent's duties under Section 454 German Commercial Code, Section 461 para 2 of the German Commercial Code stipulates unlimited liability of the forwarding agent. This also applies with regard to losses caused by delay. The forwarding agent is excluded from liability, however, if he can prove that the damage could not be prevented by application of the standard care of an orderly merchant.

If the forwarding agent carries out the transport himself (Section 458), if a fixed amount is agreed upon as remuneration (Section 459) or if the goods are dispatched with goods of another shipper according to a collective consignment contract (Section 459) the forwarding agent has the rights and obligations of a carrier. Therefore, in the aforementioned cases, the liability regulations for carriers apply.

Useful links:

- www.dvz.de
- www.transportrecht.de
- www.transportrecht.org

XXXII. Insurance

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If you want to do business in Germany, you need to deal not only with business opportunities, but also, as a precaution, with the associated risks, which means being adequately insured. Professional risk management is extremely important for the protection of the company, but also to protect business owners themselves and management personally against economic losses.

First of all, you need to work out which specific business activities involve risks and how high the probability of occurrence and the conceivable extent of the losses are. Being precisely aware of these risks is fundamentally important in order to choose the right insurance coverage and also to optimize profitability of the company. At a minimum, risks that pose a threat to the existence of the company should be fully passed on to insurance carriers.

Moreover, in Germany, you need to think about mandatory individual insurance: as soon as a company becomes an employer, it must then pay statutory social security contributions (health, unemployment, pension, care, and accident insurance). Please refer to chapter XXVII. Employment and Labor Law in this respect.

In addition to the legally required insurance, there is a wide variety of insurance designed to secure against various risks such as personal injury, property damage, and financial loss. Some of the major insurance types are listed here, although a review of individual needs must be performed on a case-by-case basis to check whether you are appropriately insured, but not over-insured.

1. Business Liability Insurance

Staff, materials, or products may cause damage to third parties or third-party property (e.g., consequential damage from an accident resulting from a source of danger that was not sufficiently secured). Any such damage and consequential damage may rapidly become a threat to the company's existence. Business liability insurance is therefore highly advisable. The coverage of liability insurance includes not only the examination of the obligation to pay damages, but also defense against unfounded claims ("passive legal protection function"), including the costs of any legal defense.

If there is a risk of pollution of ground, water, or air as a result of handling hazardous goods, business liability insurance should also be combined with environmental liability insurance.

2. Business Interruption Insurance

If buildings, facilities, supplies, or premises become unusable in whole or in part as a result of property damage, loss of revenue is to be expected due to limited operations, although fixed cost will continue to be incurred. Business interruption insurance covers the loss of operating income and expenses from ongoing cost.

3. IT Liability Insurance

IT liability insurance is special liability insurance for the IT industry, which, among other things, ensures against claims for compensation by third parties. Exceptional circumstances such as loss of data, but also programming errors or a virus can turn into serious risks that should be insured. The insurance is liable, e.g., in case of claims for damages arising from loss of profits, regulates compensation claims of injured clients or pays the expenses for recovery of lost data. Many insurers offer optional protection against the consequences of cyber attacks, which can be important in particular for website operators, such as online shops.

4. Pecuniary Damage Liability Insurance

The target group of this particular form of liability insurance includes mainly service providers, who protect third-party asset interests and work in a consulting, auditing, verifying, or certifying role. These include lawyers, notaries, accountants, doctors, and architects. Damage caused by breach of the contractual duty of

care relating to assets and that cannot be assigned to or derived from damage to persons or property is covered by pecuniary damage liability insurance.

5. Directors & Officers Pecuniary Damage Insurance

Executives, directors of public companies, supervisory boards, authorized representatives, and other corporate bodies bound by the duty of care of a prudent and conscientious manager (as defined in the provisions of the German Limited Liability Companies Act *("GmbH-Gesetz")* or German Stock Corporation Act *(Aktienges*etz) should be covered with directors and officers pecuniary loss insurance (referred to as D&O insurance), because they are liable to pay damages incurred by the company and under certain circumstances also by third parties from their personal assets as a result of their misconduct. The insurance covers internal damage (to the company), as well as external damage (to customers, competitors, employees, etc.). It is important that, in view of the risks involved, adequate coverage levels are agreed, because there may be liability scenarios that threaten the existence of the company or that could even destroy it as a result of the personal liability of those involved.

6. Fidelity Insurance

Property damage caused by persons in a position of trust at a company due to prohibited acts committed such as theft, tampering, fraud, or embezzlement can be covered by fidelity insurance. Both internal and external damage are generally covered.

7. Bad Debt Insurance

Bad debt insurance (including trade credit insurance) is intended to prevent a company being left with outstanding debts and encountering financial difficulties itself as a result. Once a payment is more than two months in arrears, e.g., you contact the insurance company, which then, instead of an expensive debt collection agency, assesses the customer's creditworthiness and first estimates the possible default risk. If necessary, the insurance company will accept responsibility for the default risk. In most insurance contracts, a deductible of about 20% is specified.

8. Product Liability Insurance

Producing companies (especially manufacturing and processing companies) and suppliers should also protect themselves against financial loss from defective products with product liability insurance, because such damage is not normally covered by conventional liability insurance. Incorrectly supplied components that may cause damage to the final product and thus trigger further consequences with high costs, such as replacement of the defective component, are covered by this insurance. Product liability cases threaten the existence of companies because they can result in an immediate cessation of sales or even a recall, in addition to the huge compensation claims.

9. Installation Insurance

Installation companies, manufacturers, and suppliers of technical equipment or machinery of any kind can use installation insurance to protect themselves against unforeseen damage to the property, the machinery, equipment, and tools used for the assembly. This covers damage that may arise due to improper installation or operating errors, but also due to design flaws and force majeure during the period from start of the installation until acceptance by the client. For smaller scale installation work, individual contracts will usually be concluded; general insurance automatically insures all assembly activities, and a revenue policy is based on the installation volume.

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10. Industrial Fire Insurance

Fire insurance not only covers fire damage to the property, such as commercial premises or other parts of the property, but also consequential damage and repairs thereof, as well as any resulting damage to company property. If the building sum insured is less than €1 million, this insurance is called commercial fire insurance. If the sum insured is over €1 million, it is called industrial fire insurance. Some commercial building insurance already includes protection against fire damage, so no separate fire insurance has to be purchased.

11. Conclusion

As a result of the fact that often very complex risk evaluations that are important to the existence of the company involve highly interconnected issues with various interactions that are not easily comprehensible to the layperson, it is advisable to perform the risk analysis with direct involvement of experienced insurance experts. The right insurance package avoids the company being either over-insured or under-insured and its terms and conditions do not include any nasty surprises when a claim has to be made.

Only a passing reference is made here to the fact that it may be necessary in the course of business to ask contractual partners about the extent of their insurance coverage and even stipulate this in the contract.

XXXIII. Pharmaceuticals, Medical Devices, Health Advertising, Foodstuffs

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1. Pharmaceuticals (Medicinal Products)

a. Legislation

The German Pharmaceuticals Act of 1976 *(Arzneimittelgesetz)*, also referred to as "Drug Law" or "Medicinal Products Law," in this section the "Act") has undergone several major revisions. Its current version was adopted on December 12, 2005 (Federal Gazette I, page 3394), amended most recently on March 27, 2014 (Federal Gazette I p. 261). Several amendments of the Act relate to the alignment of German law to EU legislation for the purpose of creating a safe and competitive common market of needed medicines at affordable prices, and creating incentives for innovation and industrial development.

The Act aims at the safe marketing of drugs and pharmaceutical products for human beings and animals, ensuring in particular quality, efficacy and safety by means of a governmental authorization procedure. Germany has one of the strictest pharmaceutical regulatory regimes within the EU.

b. Products Covered

The term 'medicinal product,' as used in the Act, relates, in short, to products influencing the condition or relying on chemical reactions of the body to influence its condition. In other words, these pharmaceuticals achieve their principal action by pharmacological, metabolic or immunological means. This includes substances or preparations of substances intended for human or animal use as remedies with properties for the curing, alleviating, or preventing of human or animal diseases or symptoms, to restore, correct, or to influence physiological functions through pharmacological, immunological, or metabolic effects, or to make a medical diagnosis. The term "substances" relates to chemical elements and chemical compounds as well as their naturally occurring mixtures and solutions, and, whether in the processed or crude state, to plants, parts of plants, and plant constituents, to the bodies of animals, including those of living animals, as well as parts of the body, body constituents, and metabolic

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products of human beings or animals, as well as micro-organisms, including viruses, as well as their constituents or metabolic products.

The Act applies also to objects, which contain a medicinal product or surfaces to which a medicinal product is applied, certain veterinary instruments, and objects.

c. Products not Covered

The term 'medicinal product' does not apply to foodstuffs, feedingstuffs, and cosmetic products regulated by the Food and Feed Code, tobacco products regulated by the Tobacco Act, and certain other substances or preparations, biocidal products regulated by the Act on the Protection against Hazardous Substances, certain medical devices and accessories regulated by the Medical Devices Act, and organs regulated by the Transplantation Act. Exceptions further apply to medicinal products manufactured using pathogens or biotechnology and intended for use in the prevention, diagnosis, or cure of epizootics, the procurement and marketing of germ cells for the artificial insemination of animals and tissues, which are removed from a person in order to reinsert them without changing their material structure into the same person in one and the same surgical procedure.

d. Marketing Conditions

The marketing or use of unsafe medicinal products is prohibited. Medicinal products are considered unsafe if there is reason to suspect that use in accordance with the intended purposes has a harmful effect, which exceeds the limits considered tolerable by current medical standards.

Medicinal products may only be placed on the market by a pharmaceutical entrepreneur whose registered place of business is situated either within Germany or in another Member State of the European Union, or another State that is a party to the Agreement on the European Economic Area. If the pharmaceutical entrepreneur appoints a local representative, the appointment does not release him/her from his/her legal responsibility. The product must bear the name and address of the pharmaceutical entrepreneur.

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e. Labeling

Finished medicinal products (which are not intended for clinical trials or otherwise exempted from the obligation to obtain a marketing authorization) may only be placed on the German market if certain information is displayed on the container or outer packaging, such as the intended use in the case of non-prescription medicinal products, the name and address of the pharmaceutical entrepreneur, and the name of an appointed local representative, the name of the medicinal product, details of the strength and pharmaceutical form, information on the scope and method of intended administration, certain information on active substances, content by weight, volume or number of units, as well as the marketing authorization number, the batch identification or the date of manufacture, the expiry date, and in the case of medicinal products which may only be dispensed upon prescription by a physician, dentist or veterinarian, the indication "prescription-only" *(verschreibungspflichtig)*. In the case of medicinal products, which may only be dispensed to consumers in pharmacies, the packaging must bear the indication "pharmacy-only" *(apothekenpflichtig)*. Further, labeling must include the warning that medicinal products are to be kept out of the reach of children. With certain exceptions, labels must contain precautions for the disposal of unused medicinal products or other special precautions to avoid hazards to the environment.

f. Instructions for Use

Packaging of finished medicinal products must contain a leaflet bearing the heading "Instructions for Use" *(Gebrauchsinformation)*, which contains specific user information as prescribed by the Act.

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g. Manufacturing Authorization

Parties intending to professionally or commercially manufacture medicinal products, test sera, test antigens, active substances of human, animal or microbial origin, or using genetic engineering, or other substances of human origin, require an authorization.

h. Marketing authorization *(Zulassung)*

Finished medicinal products may be placed on the German market upon marketing authorization by the competent German federal authority or by the European Community or the European Union pursuant to Article 3 paragraph 1 or 2 of Regulation (EC) No. 726/2004 in conjunction with Regulation (EC) No.1901/2006 of the European Parliament and of the Council of December 12, 2006 on medicinal products for paediatric use, and amending Regulation (EEC) No. 1768/92, Directive 2001/20/EC, Directive 2001/83/EC and Regulation (EC) No. 726/2004 (OJ L 378 of 27.12.2006) or Regulation (EC) No. 1394/2007.

A marketing authorization is not required for (i) medicinal products manufactured under certain circumstances in a licensed pharmacy in an amount of up to one hundred packages per day, (ii) for medicinal products manufactured from substances of human origin which are either intended for autologous use or for targeted administration to a specific person, or are prepared on prescription for individual persons (with exceptions), (iii) for certain other medicinal products manufactured for pharmacies to fill a prescription for a specific patient, (iv) as cytostatic preparations or for parenteral nutrition, (v) in other medically justified cases of special need if no other necessary medicinal product is available, (vi) as a blister, or decanted, from unchanged medicinal products, or (vii) if products are intended for use in human beings, show antibacterial or antiviral efficacy and are intended for the treatment of a dangerous communicable disease the spread of which requires an immediate supply of specific medicinal products in excess of normal requirements and are manufactured from active substances which have been stored for this purpose by Federal and State health authorities, or agencies designated by them, provided they are manufactured and sold in a licensed pharmacy. Further exceptions apply to products which require a different, separate marketing authorization and for certain other products such as curative waters, moor muds for baths or other peloids which are not manufactured in advance and are not intended to be placed on the market in a specific packaging for sale to the consumer, or which are intended exclusively for external use or for inhalation on the premises, for medicinal gases, therapeutic allergens manufactured to order for individual patients, products intended for use in clinical trials on human beings, certain medicated feedingstuffs.

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i. Clinical Trials

The sponsor, the investigator, and all other persons involved in a clinical trial must fulfill the requirements of good clinical practice laid down in Article 1 paragraph 3 of Directive 2001/20/EC. Clinical trials of medicinal products on human beings may commence only if the competent ethics committee has issued a favorable opinion and the relevant federal authority has given its approval. Sponsors or representatives of a sponsor must have a registered place of business in a Member State of the European Union or in another State party to the Agreement on the European Economic Area.

2. Medical Devices

In Germany, the sector of medical devices is regulated by the Medical Devices Act *(Gesetz über Medizinprodukte – MPG)* of August 2, 1994 (Federal Law Gazette I, p. 1963), as amended most recently by Article 4 paragraph 62 of the Law of August 7, 2013 (Federal Law Gazette. I p. 3154). The statute serves the implementation and adoption of Directive 90/385/EEC of the Council of June 20, 1990 for the purpose of harmonizing the law of the EU Member States concerning implantable medical devices (OJ L 189 p. 17), as most recently amended by Directive 93/68/EEC (OJ L 220 p. 1), by Directive 93/42/EEC of the Council of June 14, 1993 concerning medical devices (OJ L 169 p. 1), as

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most recently amended by Directive 2001/104/EC (OJ L 6 p. 50), and Directive 98/79/EC of the European Parliament and the Council of October 27, 1998 concerning in-vitro-diagnostic medical devices (OJ L 331 p. 1) (see also www.dimdi.de/static/en/mpg/recht/index.htm).

The term "medical device" is commonly used for an instrument, apparatus, implant, in vitro reagent, or a similar or related product used to prevent, diagnose, or treat a disease or other medical condition provided this purpose is not achieved through a chemical action within or on the body.

Annex IX of Council Directive 93/42/EEC classifies medical devices in essentially four classes, ranging from low risk to high risk. The classification depends on the medical device's duration of body contact, invasive character, use of an energy source, effect on the central circulation or nervous system, diagnostic impact, or incorporation of a medicinal product.

a. Declaration of Conformity

The declaration is issued by the manufacturer itself, however, for products in Classes Is, Im, IIa, IIb or III, conformity must be verified by a Certificate of Conformity issued by a Notified Body, which is a public or private organization accredited to validate compliance of a given device to the relevant European Directive. Medical devices of class I (provided they do not require sterilization or do not measure a function) can be marketed by self-certification. Certified medical devices should have the CE mark on the packaging and insert leaflets.

b. Medical Device Packaging

Medical device packaging is highly regulated and should show harmonized pictograms and standardized logos to indicate essential features such as instructions for use, expiry date, manufacturer, sterile, or don't re-use warnings.

For details of the German Medical Devices Act see link at the end of the section.

3. Health Advertising

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Health-related advertising is regulated by the Health Advertising Law *(Heilmittelwerbegesetz – HWG)* of July 11, 1965, as restated on October 19, 1994 and amended most recently on October 19, 2012.

The law applies to advertising relating to medicinal products (drugs), medical devices, and other products if the advertising relates to the diagnosis, cure, relief, or abatement of a medical condition such as an illness, injury, or ailment of human beings or animals, as well as to plastic surgery without medical indication.

Misleading advertising is prohibited. An advertisement is misleading if it claims, in particular, an efficacy or effect which does not exist, if it advertises a guaranteed success, the absence of detrimental effects in case of long-term use, if it conceals the intent of advertising, if it contains untrue or misleading statements regarding the composition or property of a medicinal product, medical device or other product or a treatment, or contains incorrect information on the identity, education, ability, or records of the manufacturer, inventor, or related persons.

Advertising is illegal if the advertised product has not been approved for marketing or approved for a different indication or form of application.

Section 4 prescribes certain clearly legible doctor and patient information relating to the identity and domicile of the manufacturer, the name, composition, and indication of the drug, contra-indications, side effects, prescribed warnings, and the need of a subscription in case of a subscription drug. Regarding medicinal products for animals, the waiting period must be stated during which the treated animal does not qualify for human consumption. Other requirements apply. Medicinal products, medical devices, or treatments advertised to parties other than members or institutions of the medical or veterinarian professions, or to parties permitted to trade with such products must bear the indication: "For risks and side effects read the package folder and ask your doctor or pharmacist" (not applicable to certain products permitted to be sold outside pharmacies).

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Advertising of just a product name and manufacturer name (without indication and any other information or claim) is exempt to some extent. The package information may not contain advertising for other products.

It is generally prohibited to advertise with expert opinions or certifications, which are not of qualified scientific or expert origin and which do not state the name, profession, place of residence of the author and the date when it was issued. Citations from scientific publications must be literal and faithful.

The law regulates the extent to which members or institutions of the medical or veterinarian professions, or parties permitted to trade with such products may be offered, or may accept, a benefit, gift, or other promotional present.

Detailed rules regulate the advertising of teleshopping opportunities, of imported products not authorized for sale in Germany, or of treatments by distant service (not based on personal examination of a patient).

Prescription drugs may not be advertised except to doctors, dentists, veterinarians, pharmacists, and persons permitted to trade with such products.

Regarding advertising to the public (as opposed to members or institutions of the medical or veterinarian professions, or parties permitted to trade with the advertised products), certain limitations apply regarding advertisements, which contain testimonials of academics, members of the medical professions, or celebrities. Public advertising may not contain patient histories or content that may prompt incorrect self-diagnoses, it may not contain misleading visual depictions of medical conditions of the human body, it may not suggest that the omission or the use of a product may impair or improve health. Public health advertising may not feature misleading statements, acknowledgements or recommendations, may not be directed at children below the age of 14 and may not be connected with promotional contests of sweepstakes promoting an abuse of medicinal products or medical devices.

Other restrictions apply.

4. Foodstuffs

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Food safety is regulated in the Food, Utensils, and Animal Feed Act *(Lebensmittel-, Bedarfsgegenstände- und Futtermittelgesetzbuch – LFGB)*. The provisions incorporate animal feed in the food production chain, ensuring a global concept of farm-to-table safety. The provisions create uniform standards, e.g., as regards criminal or administrative offenses. The Act has been repeatedly amended; recent amendments include, inter alia, the introduction of an early warning system for foodstuffs containing dioxin.

The Act aligns German national provisions with requirements of the relevant EU law, using an integrated approach that aims at a high level of food safety, animal health, animal welfare, and plant health within the EU through coherent farm-to-table measures and adequate monitoring, while ensuring the effective functioning of the internal market.

The most important EU Acts in the area of food safety are (i) Regulation 178/2002/EC, laying down the general principles and requirements of food law, (ii) the "Hygiene Package" on the hygiene of foodstuffs and the referring official controls and (iii) Regulation 258/97/EC concerning novel foods and novel food ingredients.

Other EU law provisions include rules on labeling, presentation, and advertising of foodstuffs. Details that must appear on packaging include the name under which the product is sold, a list of ingredients and quantities, potential allergens, the minimum durability date, and conditions for storage.

Recently, due to the need for control and evaluation of GMO's (genetically modified organisms), legal regulation in this field has been taking place at EU and German national level. The national German Act in the sector of genetic engineering, the Genetic Engineering Act *(Gentechnikgesetz)*, seeks to protect human and animal health and the environment from potential adverse effects of genetic processes and products.

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Food supplements are foods intended to supplement a normal diet, containing a broad spectrum of nutrients or other substances. Food supplements must be identified as such, details are stipulated in the Food Labeling Ordinance specifying the required information on recommended daily intake as well as warnings concerning excessive consumption. As any food, the food supplements are regulated by the LFGB, including issues such as safety, consumer information on the package, and the prohibition of health claims (with certain exceptions).

The Food Supplements Ordinance (NemV) determines which vitamins and minerals can be added to foods. There are currently no binding rules on maximum quantities of food supplement ingredients on the German or European levels. Consumer protection in the sector of food supplements (vitamins, minerals, trace elements, and other substances available as capsules, tablets, powders or in liquid form) aims at reducing possible health risks due to misleading information.

Food supplements as such do not require approval but must be registered with the Federal Office of Consumer Protection and Food Safety (BVL). Special provisions apply to imported products, which do not comply with German regulatory requirements.

Food advertising is regulated both on an EU level and on a German national level. In 2005, the European Commission has issued a "Green Paper" in support of healthy diets and physical activity to avoid overweight, obesity and chronic diseases. There is a EU "Platform for Action on Diet, Physical Activity and Health" as well as a "European Network on Nutrition and Physical Activity." Further regulations originate from the "European Food Safety Authority" (EFSA) and the WHO/FAO report on recommended nutrition intake and similar programs. Regulations also relate to nutrition and health claims made on foods (EU Regulation No. 1924/2006, in effect as of July 1, 2007). EU Directive 2000/13 of March 20, 2000, in effect since June 2000, regulates labelling, presentation and advertising of food stuffs ("Food Stuffs Labelling Directive"). Further restrictions apply on the basis of the EU Unfair Commercial Practices Directive 2005/29 of May 11, 2005 (in effect since June 12, 2005). Television advertising restrictions result from EU Directive 89/552 of October 3, 1989, as amended by Directive 97/36 (Article 12: no encouraging of behaviour prejudicial to health and safety, Article 13: general ban on television advertising of tobacco products, Article 15: TV advertising for alcoholic beverages may not be aimed specifically at minors or depict minors consuming these beverages; Article 16: TV advertising shall not directly exhort minors to buy a product or a service by exploiting their inexperience or credulity, directly encourage minors to persuade their parents or others to purchase an advertised good or service, exploit the special trust which minors place in parents, teachers or other persons, or unreasonably show minors in dangerous situations.

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Useful links:

- http://www.bundesgesundheitsministerium.de/en/en/ministry/the-federal-ministry-of-health.html
- www.gesetze-im-internet.de/englisch_amg/index.html
- www.rki.de/EN/Home/homepage_node.html
- www.pei.de/EN/home/node.html
- www.bfarm.de/EN/MedicalDevices/_node.html
- www.bvl.bund.de/EN/Home/homepage_node.html
- http://www.bundesgesundheitsministerium.de/en/en/ministry/laws.html

XXXIV. Civil Law Notaries' Services for Corporate and Real Estate Investors and Private Clients

1. Integrated Services by our Notaries and our Lawyers

In accordance with their professional rules, our Notaries work closely together with our lawyers. Integrated services are possible in situations in which there are no conflicts of interests. Examples are matters in which lawyers and Notaries are instructed by the same client/s, e.g., concerning general corporate structuring, or corporate structuring within a group after a concluded transaction, or the planning and setting up of estates.

2. Notaries as Legal Advisors

A civil law notary ("Notary") in Germany is an independent holder of a public office. Depending on the federal state, there is the "only-notary" *(Nur-Notar)* or the "lawyer-notary" *(Anwaltsnotar)*. The former provides only notarial services and is therefore also referred to as "single profession notary," the latter exercises the profession as an additional office together with his practice as a German lawyer *(Rechtsanwalt)* and can either perform notarial services or work as a normal lawyer/attorney.

Due to his different professions, a lawyer-notary acts in his role as Notary as independent and objective adviser for all parties of the notarial deed. In his capacity as lawyer, however, a lawyer-notary can, like any lawyer, work under instructions from clients in negotiations or disputes in relation to other parties. Therefore, the lawyer-notary has to decide and advise the clients at the outset of his involvement in each matter whether he will be acting in his capacity as Notary or in the role of a lawyer/attorney.

The lawyer-notaries of Heuking Kühn Lüer Wojtek look after German and foreign clients, at their offices they notarize notarial instruments regarding matters anywhere in Germany, and also in foreign languages if required.

3. Services for Corporate and Real Estate Investors and Private Clients

a. Notarial Form is compulsory under German law for specific matters

In business transactions that are of importance for companies or individuals, German law requires the notarial form, usually notarization, for specific agreements and transactions. In such matters, Notaries ensure that everything is done in full compliance with the law, and that the individuals involved have fully understood their commitments and have the authority to legally bind other individuals or companies, which they might represent. Such matters are, e.g., the setting up of most companies, the transfer of shares in private limited companies, the sale of land, the establishment of a legal charge or mortgage and the conclusion of matrimonial agreements, or the following examples:

b. Corporate Matters such as

- Minutes of shareholders' meetings regarding corporate structures;
- Registrations of directors in the commercial register.

c. Real Estate Matters such as

- Purchase of houses, flats, or commercial property;
- Transfer or deletion of legal charges or mortgages.

d. Private Client Matters such as

- Lifetime gifts;
- Wills.

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4. The use of Powers of Lawyer/Attorney

Especially foreign clients appreciate the know-how that our Notaries have developed in respect of drafting and making use of PoAs. Such PoAs authorize our notarial clerks to notarize deeds on behalf of the principals. Frequently, such PoAs themselves do not require notarial form, which can ease the conclusion of notarial acts for our clients considerably.

5. Costs of Notarial Acts

Although in public office, the Notary is not paid by the State. The Notary charges fees to the individuals or companies involved in his notarial acts. Such fees are fixed by law and usually depend on the value of the matter concerned, but many caps are in place, either related to the underlying values or the fees as such.

6. Summary

German Notaries offer impartial notarial services to all parties in respect of projects in Germany. Compulsory statutory law requires notarial instruments for specific corporate, real estate, and private client agreements and transactions.

Useful link:

- Bundesnotarkammer (Body established and governed by federal law representing the German civil law notaries): www.bnotk.de/en/index.php

XXXV. Litigation and Lawyers

1. The Court System in Germany

The German court system is divided into three different types of courts:

- ordinary courts for civil, commercial and criminal matters;
- specialized courts in certain areas of the law, such as public administration, labor, social security, tax, or patent matters;
- constitutional courts review judgments or legislative acts for possible violations of a state or federal constitution.

Ordinary and specialized courts have their own tracks for appeals.

In the German judicial system, cases are mainly decided by professional judges. Exceptions apply to commercial, public administrative, social security, labor and criminal matters where lay judges are part of the panel. Decisions by a jury are unknown in Germany.

The German lawyer *(Rechtsanw*alt) is like a UK solicitor and barister, serving in and out of court. A German lawyer is admitted to all German courts except for the German Federal Court of Justice *(Bundesgerichtshof)* in civil matters. Only some 40 lawyers are admitted to that court. Parties are required to be represented by a lawyer in regional and regional appellate courts as well as in the Federal Court of Justice.

The structure of the ordinary courts can be depicted as follows:

Local or magistrates courts *(Amtsgerichte)* deal with civil disputes involving amounts in dispute of up to €5,000.00, and criminal offenses that are punished with a fine or imprisonment of up to four years.

Disputes with an amount in dispute of more than €5,000.00 are handled by regional courts *(Landgerichte)*. Its panels consist of three professional judges who are frequently specialized in particular areas of the law. The majority of cases are decided by a judge sitting alone, however. Commercial matters between

business corporations may be decided upon application by one professional judge and two lay judges.

Judgments rendered by a regional court can be appealed to a regional appellate court *(Oberlandesgericht)*. Appeals against rulings of local courts are dealt with by the regional courts. Appellate courts review law and facts of the lower courts´ decisions. Yet, as a general rule, parties are not allowed to introduce new facts during appeal proceedings.

The highest ranking court in civil and criminal matters is the German Federal Court of Justice. It only reviews questions of law in legal matters of fundamental significance. Additionally, it assures uniform application of the law throughout Germany. Like any German judicial decision, judgements of the Federal Court of Justice are not strictly binding for the rulings of other courts. They have, however, de facto an impact for lower ranking courts.

The specialized courts are also organized hierarchically with a federal court on the top level.

2. Court and Lawyer's Fees in Germany

The costs of litigation in Germany are dependent on the amount in dispute. Court fees and recoverable lawyer's fees are statutory. Fees are higher on the appellate level than on the entry level.

Court fees are collected in advance. The fees for an amount in dispute of €100,000.00 are, for example, €3,078.00 at first instance and additionally €4,104.00 at second instance. The court also collects an advance on cost for the taking of evidence, such as expert cost.

The fees of lawyers involved in litigation are set forth by the Lawyers Remuneration Act *(Rechtsanwaltsvergütungsgesetz)*. The lawyers' fees also depend on the amount in dispute, the kind of action, and the level of the court. For example, for an amount in dispute of €100,000.00, both lawyers are entitled to €4,495.23 at first instance and an additional €5,031.80 at second instance.

The losing party bears the courts' and the lawyers' fees as well as reasonable other expenses. Agreements between the party and the lawyer on hourly rates are permitted but not refundable from the opposing party if they exceed the statutory fees.

For services on civil proceedings, the statutory lawyers' fees represent the minimum remuneration.

For out-of-court professional services, lawyers can stipulate hourly rates or lump sum compensation. Contingency fees are only permitted under very narrow circumstances.

3. Procedures and Duration of Proceedings

A statement of claim must contain a designation of the parties and the court as well as a substantial presentation of the facts and the grounds for filing the claim including a precisely specified motion *(Antrag)*. The German Code of Civil Procedure *(Zivilprozessordnung)* further requires that both claimant and respondent list the evidence they wish to present to the court to prove disputed facts. Evidence can be a visual inspection of objects such as pictures, witnesses, or expert opinions, documents, or the testimony of the opposing party. There is no pre-trial discovery.

The most crucial aspect in German civil procedure is the exchange of legal briefs. Thereafter, the court will set a hearing date. In most cases, the first oral hearing is not used for the taking of evidence, but rather the court communicates its preliminary assessment of the case and asks the parties for possible options to settle the case. There is rarely an extensive oral presentation or a lengthy closing argument. In civil matters, the court generally rules within four up to six weeks after the hearing. This ruling can be an order to take evidence of any

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kind, the granting of a period for further submissions on certain issues of the case, or a final judgment.

Each year, the German court system handles about three million lawsuits, 1.5 million of which are civil matters. On the entry level, about 60% to 80% of all civil cases are heard within six months after filing. The local and regional courts render civil judgments usually within 12 up to 18 months. Appellate proceedings may take longer, depending on the workload of the panel. If all permissible appeals are filed or the issues in dispute are complicated, however, it may take considerably longer until the final ruling.

If injunctive relief is sought, the courts decide if the case so requires also on a very short notice, e.g., within one or two business days.

Useful links:
- www.bundesgerichtshof.de
- http://en.justiz.de/index.php

XXXVI. Arbitration

The German Code of Civil Procedure *("ZPO")* incorporates, in its chapter 10 (Secs. 1025 et seqq. *ZPO*), a set of arbitration rules which, in principle, correspond to the UNCITRAL Model Law on International Commercial Arbitration ("Model Law"). A reference to the provisions of the United Nations Convention on the Recognition and Enforcement of Arbitral Awards 1958 ("New York Convention") is incorporated in Section 1064 *ZPO*. Germany is a signatory to the Geneva Protocol dated September 24, 1923, and to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965 ("ICSID").

The provisions of the German *ZPO* apply to any venue of arbitration in Germany or any arbitral award to be enforced in Germany.

A fundamental rule of German civil law is the principle of freedom of contract, and this principle also applies to arbitration agreements. The rules of civil procedure combine the principle of freedom of contract with the primacy of arbitration over regular court proceedings.

As concerns form requirements, an agreement to arbitrate must be in writing, either in one document signed by both parties or in an exchange of documents between the parties. These documents can be exchanged via fax or electronic data transmission, or, as is common nowadays, by email. Arbitration agreements involving consumers are subject to additional form requirements.

The German Constitution provides that judges must be independent and are bound by the law only. These requirements also apply to arbitrators. Accordingly, proposed arbitrators must disclose, prior to their appointment, any facts or circumstances which may give rise to doubts as to their impartiality or independence.

The appointment of an arbitrator can be challenged if there are justifiable doubts with respect to the arbitrator's impartiality or independence. A party appointing, or agreeing to the appointment of, an arbitrator may challenge that appointment

only for reasons discovered after the appointment. Any request to challenge an arbitrator must be unambiguous.

The arbitral tribunal determines the rules of procedure for an arbitral proceeding at its own discretion, unless the parties have agreed otherwise or an overriding statutory rule prevails. The parties have the burden of introducing into the proceedings all facts, circumstances, and supporting evidence relevant to the case. As concerns fact-finding and evidence, the *ZPO*, like the Model Law, provides the basic rules which protect fundamental standards of due process. The civil law-style procedure grants the arbitral tribunal the power to actively manage and monitor the proceedings instead of observing the adversarial actions of the parties passively. As procedure is determined by the arbitral tribunal at its discretion, however, unless otherwise agreed by the parties, a passive approach is possible.

The parties' options to investigate facts are rather narrow in German civil proceedings. The available facts must be presented in detail and a court will not use the procedure of taking evidence to investigate facts that were not previously presented to the court. Generally, however, an arbitral tribunal is not required to observe the locally applicable procedural rules on specific means of taking evidence and may conduct the evidentiary proceedings at its reasonable discretion. In recognition and enforcement proceedings of an arbitral award, the court may not judge the evaluation of the evidence by the arbitral tribunal (no *révision au fond)*. The court may determine, however, whether a party's right to be heard was violated if evidence offered by the party was not considered in the proceedings at all.

Arbitral tribunals do not have the power to require the attendance of witnesses or enforce the production of documents. The arbitral tribunal, or a party with the approval of the arbitral tribunal, may, in this respect, request the assistance of the courts to take evidence or adopt and enforce procedural measures which are not within the competence of the arbitral tribunal. The court may execute the request within its competence and according to its rules on taking evidence.

An arbitration agreement does not prevent a party from seeking injunctive relief from the public courts, either before or during arbitral proceedings. The arbitral tribunal may also order any appropriate measures after having heard both parties. Depending on the order, however, the arbitral tribunal cannot always enforce its order (though it may sanction non-compliance in a costs award). Accordingly, it is the court, on request of either party, that orders the enforcement of an arbitral order. The court may, however, change the arbitral order and is entitled to rescind or change the enforcement order on request of a party. If the interim measure turns out to be unjustified from the outset, the detrimentally affected party is entitled to claim damages in the pending arbitration or before a court.

After an award has been rendered in an arbitral proceeding, any party can request the arbitral tribunal to correct calculation errors, typographical or similar errors, to interpret parts of the award, or to render an additional award on claims presented in the arbitration but omitted in the award. The correction or interpretation of an award is not a separate award but part of the original award. An award on claims which had been presented in the arbitral proceeding but omitted in the initial award constitutes a new final award that can be enforced separately.

Recourse against an arbitral award to the courts is possible in line with the provisions of the New York Convention, only if the petitioner shows that: (i) the arbitration agreement is invalid, (ii) the party was not given proper notice or was otherwise unable to present its case, (iii) the award deals with a dispute not contemplated by the terms of the submission to arbitration, or (iv) the composition of the arbitral tribunal or the procedure was not in accordance with the agreement of the parties. Further, an appeal is possible if the court finds that the subject matter of the dispute was not arbitrable or if the award was in conflict with the *ordre public*. This appeal option applies only to awards rendered in a German venue arbitration proceeding. The appeal judgment can set the award aside, either in full or in part, with *ex tunc* effect. The appeal judgment may not, however, modify the award. There are appeal deadlines to be observed.

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With respect to the enforcement of arbitral awards, German law distinguishes between domestic and foreign awards. The enforcement of a domestic arbitral award requires a request to the Higher Regional Court (*Oberlandesgericht)* designated by the parties in their arbitration agreement or to the Higher Regional Court of the district in which the arbitration took place. The enforcement of foreign awards in Germany is set out in Section 1061 *ZPO*, which incorporates the rules of the New York Convention. Alternatively, a party may choose the system of recognition and enforcement of an arbitral award according to the more general rules of the *ZPO*, if this system is more favorable.

Useful links:

- www.dis-arb.de
- www.iccgermany.de
- www.gmaa.de
- www.adic-germany.de

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