Luther News, May 2011

German Law & Business News

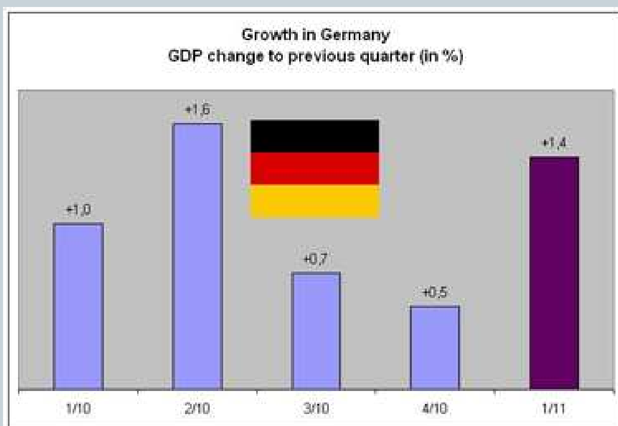
A quarterly review of current legal and tax developments in Germany

Editorial

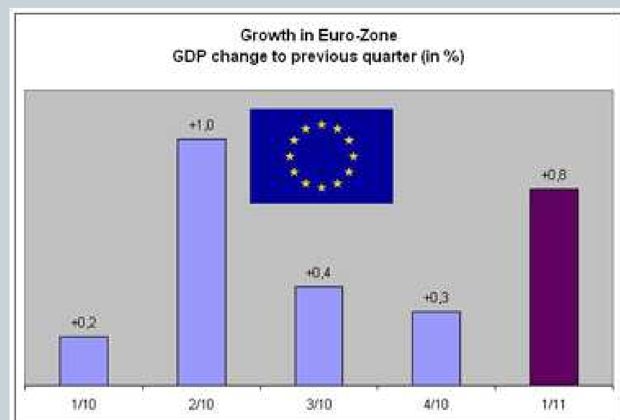
Dear Reader,

Fukushima and the ensuing discussion about nuclear power as an energy resource, Arab revolutions and their effects on oil prices and last, but not least, Europe's sovereign debt saga continue to dominate headlines and lunch discussions. While Europe's fiscal policy makers and the European Central Bank do not give the impression of very constructive talks, business leaders are wondering how bad things really are, whether Greece will leave the euro zone and what it all means for their own decisions. Is Europe currently facing an existential crisis or doing remarkably well, considering the circumstances?

According to Eurostat the euro area is expected to experience GDP growth of 0.8% for the first quarter of 2011 (which is an annual increase of 2.5%, compared with the first quarter of 2010; in comparison, the US only saw growth of 0.4% in Q1/2011 (a 2.3% increase compared to last year). European growth is driven by Germany, making up 27% of the total euro area GDP, and France, contributing 21% of total GDP. Both countries' GDP grew by 1.4% and 1% respectively in the first quarter of 2011. While still facing a structural deficit of likely around 3.5% of GDP in 2011, Germany's Federal Ministry of Finance expects considerably higher revenues. Some German politicians such as the new liberal leader Rösler of the FDP, the junior partner in Chancellor Merkel's coalition government, or Bavaria's Minister of Finance are once again calling for tax reliefs.



Source: Statistisches Bundesamt



Source: Eurostat

On May 24 Ifo Institute for Economic Research published the current update to its well-known Business Climate Index, the leading indicator for economic activity in Germany: Last month, the index felll (from) 111.3 in February and 111.1 in March) to 110.4. According to a commonly accepted rule, a rule which has not failed for more than 25 years, another fall would indicate a cyclical turning point. Yet the index remained steady. The German Bundesbank even considers it possible that Germany will enjoy a lasting boom.

German companies are in any case having one of their best years ever. The German business daily Handelsblatt estimates a 130% increase in profits 2010 for the 30 corporates comprising Germany's DAX-30 stock index. Businesses in Germany set their sights on continuing the boom in 2011: Car-makers like Audi continue to hire, and according to a recent survey conducted by the American Chamber of Commerce in Germany, nearly 60% of US businesses active in Germany intend to increase their investments.

Best wishes

Eike Fietz and Thomas Weidlich

1. Notarisation of a GmbH Share Transfer Abroad – yes, no, yes?!

Fixed fees for notarisations in Germany which are tied to the value of a transaction prompted many companies to notarise share transfer agreements regarding shares in German GmbH's abroad, especially in certain cantons of Switzerland where fees can be negotiated more flexibly. This common practice was abandoned in the end of 2009 following an obiter dictum of the district court (*LG*) of Frankfurt/Main. The court was of the opinion that notarisations in Switzerland would not constitute valid share transfers.

The court based its opinion on new provisions of the German law on limited liability companies (GmbHG) which were introduced in 2008. Since then, a notary must issue a new shareholder's list, if he has participated in a share transfer. According to the district court, this obligation is only imposed on German, but not on foreign notaries, therefore not giving notarisations by foreign notaries the same effect.

A most recent ruling of the higher regional court (OLG) of Dusseldorf on 2 March 2011 came to the conclusion that a shareholder's list may also be issued by foreign notaries, and that notarisations in Basel/Switzerland are accordingly valid under German law. The reasoning for this is that the new provisions of the GmbHG do not prohibit notarisations abroad, as long as the foreign notarisation is comparable to those done by German notaries. Under established practice, notarisations in a number of Swiss cantons are considered comparable.

The decision by the OLG Dusseldorf is the first ruling of a higher court which dissents with the trouble-causing decision of LG Frankfurt/Main. However, as long as the Federal Court of Justice (*BGH*) has not delivered a final judgment on this issue, notarisations abroad bear a certain risk. (JFI)

2. Online Participation in General Meetings of a German Stock Corporation

We are currently in the midst of *Hauptversammlungssaison*, the season of AGMs for German listed companies. For international stockholders, this brings to mind the question of whether to travel to Germany or to take part in any other way. In this context, the European Shareholders' Rights Directive comes to mind, which was implemented into German law in 2009 by the Act Implementing the Shareholders' Rights Directive (*ARUG*). One of its key aspects is the online participation of shareholders in general meetings of a German stock corporation (*Aktiengesellschaft*). Under certain circumstances it is now possible to participate in AGMs via the internet and to cast votes by way of electronic communication. Generally, the German Stock Corporation Act (*AktG*) still assumes the model of physical presence of the stockholder or a proxy holder at the general

meeting. However, the articles of association of a corporation may now provide for, or may authorise the management board to establish the legal basis to use means of electronic communications. If this is put into effect, all individual rights in whole or in part may be exercised by way of electronic communication (sec. 118 para. 1 AktG). Similarly, shareholders may vote, without participating in the general meeting, in writing or by way of electronic communication (sec. 118 para. 2 AktG). In contrast to the latter, online participation pursuant to sec. 118 para. 1 AktG enables the shareholder to react in real time to occurrences at the general meeting and to influence them directly. In the event of online participation the shareholder is legally present at the general meeting and may, for example, afterwards object against resolutions of the general meeting which were formally recorded in the minutes, and file a subsequent contesting action. However, technical problems in connection with an online participation or an electronic voting are, as a rule, not sufficient for alleging a violation of shareholder rights. A contesting action cannot be based on a violation of rights exercised electronically pursuant to, inter alia, sec. 118 para. 1 and 2 AktG where the violation was caused by a technical malfunction, unless the company can be accused of gross negligence or intent (having said this, however, the articles of association may provide for a stricter standard of fault). (MAP)

3. Corporate Bonds: A New Financing Trend in Germany

Over the past 12 months debt financing by way of corporate bonds has become more and more popular amongst German corporates, including SMEs. The German Stock Exchanges have reacted to this new trend and now provide special trading platforms for corporate bonds such as BondM (Stuttgart), Entry Standard for Corporate Bonds (Frankfurt), m:access bonds (Munich), mittelstandsmarkt (Düsseldorf) and Mittelstandsbörse (Hamburg/Hanover). The inclusion of bonds for trading on the various trading platforms is regulated by the respective stock exchange (so called “Open Market”). By and large, these rules are quite similar. However, in some aspects they also differ.

Traditionally, the German “Mittelstand” prefers debt financing and is very reluctant to equity capital markets exposure, fearing loss of control and enhanced transparency by offering shares to the public. However, since the global financial crisis bank loans are hard to come by and alternate sources are in demand. Corporate bonds offer debt financing outside the constraints of a bank loan. Corporate bonds are debt instruments with a fixed term between five and seven years and a fixed interest rate (generally around 7%). German corporates are recovering fast from the financial crisis and again have strong balance sheets and healthy profits. Therefore, there is great appetite by institutional and private investors for corporate bonds which resulted in nearly all recent bond issues being manifoldedly oversubscribed.

The inclusion of corporate bonds for trading on one of the markets mentioned above generally requires a securities prospectus which must be approved by the German Financial Supervisory Authority (Ba-Fin) and a satisfactory credit rating by one of the leading rating agencies. The disclosure level of the bond prospectus is not quite as high as in an IPO. Furthermore, the bond issuers are bound by certain ongoing obligations such as regular publication of their audited financial statements, interim financial statements, regular up-dates of their credit rating and ad-hoc announcements of material information. (ANY)

4. Tightening of Standards for Investment Products

On 18 February 2011 the German cabinet passed a draft bill in order to reform the laws governing the so called ‘grey capital market’ (*Grauer Kapitalmarkt*). In Germany, there is a market for certain investment products (e.g. partnership interests in closed-end funds or unlisted securities), which is largely unregulated (to this extent not existing anywhere else) and which has caused enormous losses in the past to a great number of private investors. The draft bill aims at a stricter regulation of investment products, higher standards for the marketing of such products, and simplified conditions for the liability for statements made in a prospectus or in other comparable marketing materials. We will report details when

the draft bill enters the final stages of the legislative process. (EIF)

5. EU-wide Effectiveness of National Ban of a Community Trademark Infringement

With its decision of 12 April 2011, the European Court of Justice (ECJ) stated that a ban of a (imminent) Community trademark infringement issued by a national Community trademark court (CTC) applies, as a rule, to the entire area of the European Union.

The facts: A French company filed a lawsuit against a competitor for a trademark infringement with the national CTC. Inter alia, the company asked the court to extend the prohibition of the infringement to the entire area of the EU.

The ECJ issued a preliminary ruling by which it decided that a restraining order of a (imminent) Community trademark infringement issued by a national CTC is, as a rule, effective all over the EU: According to sec. 91 ff. of the Community Trademark Regulation (CTMR), the national CTCs have exclusive jurisdiction in respect of lawsuits against (imminent) Community trademark infringements and hence its territorial jurisdiction generally extends to the entire area of the EU. Pursuant to, inter alia, sec. 1 (2) CTMR, a Community trademark has a unitary character whose objective is the uniform protection in the EU. In order to protect this character effectively, such a restraining order shall therefore extend to the entire area of the EU.

An exception of this rule shall only be applicable, where (imminent) infringements are limited to just one or several member states (e.g. infringements on linguistic grounds). In such cases the national CTC is obliged to limit the territorial scope of the restraining order accordingly.

The decision of the ECJ eases the assertion of rights in the field of Community trademarks. If a restraining order issued by a national CTC regarding a Community trademark infringement would not apply EU-wide, the owner of the Community trademark would be compelled to file a variety of lawsuits with the remaining national CTCs, in order to protect the Community trademark effectively. Furthermore, diverging decisions of the national courts will be avoided. (FLT)

6. "Jesus loves you"

According to a recent ruling of the Higher Labour Court of Hamm (LAG Hamm), an employer is entitled to terminate the employment relationship with an employee who uses a religious closing phrase when talking to customers on the telephone.

The facts: A deeply religious employee was employed in a call centre of the shopping channel QVC and ended each telephone conversation with a customer using the words “Jesus loves you, thank you for your purchase at QVC and have a nice day”, thereby violating an explicit directive of his employer. In doing so, the employee referred to his freedom of religious belief and worship. The employer did not want to accept this and terminated the employment relationship.

While the employee succeeded in the first instance, the Higher Labour Court decided in favour of the employer when balancing between the employee’s freedom of religious belief and worship on the one side and the employer’s entrepreneurial freedom on the other side. The court stated that the directive of an employer based on his entrepreneurial freedom does only have to step back behind the freedom of religious belief and worship of an employee, if such employee would be thrown into major inner conflicts when following the employer’s instruction. In the case at hand the employee was not able to substantiate such major inner conflict and provide relevant evidence.

Against the background of an increasing number of court decisions on the balance between the freedom of belief and worship on the one side and the entrepreneurial freedom on the other side, the ruling confirms that an employer is principally entitled to decide what is acceptable in his company.

Only in cases where an employee is able to substantiate and prove a major inner conflict when obeying his employer’s instructions, this rule does not apply.

Therefore, employers should not let themselves get discouraged too easily when being confronted with religious aspects in the context of an employment relationship. The decision shows that religious reasons put forward by an

employee do not necessarily cause the ineffectiveness of a potential termination. (JOS)

7. Increase in German Real Estate Transfer Tax Rates

Until 2006, all of the 16 federal states in Germany applied a uniform real estate transfer tax rate of 3.5%. Since then, more and more federal states have increased their real estate transfer tax rate, lastly at the beginning of 2011.

The following schedule gives an overview of the actual real estate transfer tax rates:

State	Rate
Bavaria	3.5%
Baden-Wuerttemberg	3.5%
Berlin	4.5%
Brandenburg	5.0% (since 2011)
Bremen	4.5% (since 2011)
Hamburg	4.5%
Hessia	3.5%
Mecklenburg-Vorpommern	3.5%
Lower Saxony	4.5% (since 2011)
Northrhine-Westfalia	3.5%
Rhineland-Palatinate	3.5%
Saarland	4.0% (since 2011)
Saxony	3.5%
Saxony-Anhalt	4.5%
Schleswig-Holstein	3.5% (5% as of 2012)
Thuringia	3.5%

(PMS)

8. German Tax Authorities Facilitate Intragroup Utilization of Tax Losses

According to German tax law, tax losses of a corporation (like a GmbH or AG) are only tax deductible at the level of the German parent company, if the formal requirements of a tax group are fulfilled. This requires, inter alia, that the subsidiary must have both its seat as well as its place of management in Germany and that the companies have entered into a profit and loss pooling agreement. As a result, a utilization of tax losses of a subsidiary having its seat outside of Germany, but its effective management in Germany, is not possible.

The European Commission takes the view that these requirements are not in line with European laws. As a consequence, the German Federal Ministry of Finance has issued a decree according to which a corporation incorporated in another EU/EEA state with its place of management in Germany, can allocate its profits or losses to its tax group parent to the extent this income is based on earnings subject to German tax. Please note that this is only the position of the German tax administration and that the law has not been amended (yet). Accordingly, regarding corporations which have been established under the laws of another EU/EEA state, it is no longer required that the subsidiary in such tax group has its seat in Germany as long as the place of effective management is in Germany. All other requirements for the formation of a tax group must still be met. (PMS)

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