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German Law & Business News

A quarterly review of current legal and tax developments in Germany

Editorial

Dear Reader,

One of Germany's big corporate stories 2009 was the take-over of Porsche by Volkswagen, and 2010 ends with yet another controversial takeover battle. Spain's ACS plans to take control over Germany's Hochtief and form the world's largest construction conglomerate.

ACS, with a 29.98 per cent stake already Hochtief's largest shareholder, made use of a particularity of German takeover law and submitted a voluntary bid only consisting of ACS shares – not a very attractive prospect to Hochtief shareholders. However, ACS only needs to cross the 30 per cent threshold and would then be able to buy Hochtief shares at its own pace (when the share price is low) without having to submit a costly mandatory bid. This led to much debate in political and legal quarters, up to demands that Germany's takeover laws should be tightened. The German financial supervisory authority BaFin as well as Australia's Takeover Panel eventually permitted the bid, but it is by far not a done deal yet. Hochtief presented a familiar 'white knight', well known from the VW/Porsche saga: Qatar took a 10 per cent stake last week, only hours after FIFA announced that the emirate will host the 2022 Soccer World Cup. While this decision may have come as a surprise for many, it is certainly not new – and the fight over Hochtief has once again confirmed this – that foreign investment is welcome in Germany.

On behalf of the partners and staff of Luther Rechtsanwaltsgesellschaft mbH we wish you all the best for the Holiday Season and a successful New Year 2011!

Best regards

Eike Fietz and Thomas Weidlich

1. Current Developments in Disclosure of Financial Information

All German bodies corporate have to file financial statements in various degrees with the Electronic Federal Gazette which publishes the statements. Until the introduction of electronic filings, compliance with this obligation has been slack. At a recent conference an official of the *Bundesamt für Justiz*, which is responsible for the enforcement, reported details of the authority's practice: Whereas before the days of IT-based filings only 5 to 10 per cent of corporations filed by themselves, the number has now risen to approx. 90 per cent. Having said this, in 2008 there were about 130,000 proceedings initiated by the authority in order to impose administrative fines. 8 per cent of those were appealed, of which less than 10 per cent were successful.

The filings are entered into a database which is automatically searched by its operator for timely and complete filings. Corporations which are in violation will be reported by the operator to the authority, which – via another automated process –

imposes fines of up to EUR 25,000 plus its own fees and expenses.

This system has meanwhile been tested by the judicial system. According to the competent District Court of Bonn, appeals stand – as a general rule – little chance of success. In particular, non-compliance can not be excused by organisational problems, agreements with the fiscal authorities, data protection or liquidation of the company concerned. (EIF)

2. Transformation from an "UG (haftungsbeschränkt)" into a "GmbH"

A "normal" German limited liability company (*GmbH*) requires a minimum statutory capital of EUR 25,000, at least half of which must be paid in immediately. Since 2008, a so-called "Small GmbH" can be set up quickly without a minimum capital, but needs to use the suffix "*UG (haftungsbeschränkt)*" to make the public aware of its very low capitalisation. This suffix can be dropped and replaced with the usual suffix "*GmbH*" only after the shareholders have increased the share capital to the statutory minimum of EUR 25,000. The Higher Court (OLG) Munich has now decided that increasing the share capital alone is not sufficient, but the statutory minimum must also be paid in fully before an UG can be "upgraded" to a GmbH. (TW)

3. Gun-Jumping – A Major Issue in German Antitrust Law

In most jurisdictions mergers and other business combinations which have to be filed with the competent cartel authority may not be completed before clearance by the cartel authority. In this context, a classical gun-jumping happens when a business concentration is completed after the notification of the concentration but before the clearance by the cartel authority. Whereas the Federal Cartel Office (*Bundeskartellamt*), the German cartel authority, originally dealt with cases without any notification of the concentration, there is now an increase in the enforcement against classical gun-jumping situations in Germany and Europe.

Inadmissible completion measures of a concentration are, e.g., the full transfer of the shares, the factual control of the day-to-day business, alignment of price policy, etc. On the other side, there are some measures of completion which are not challenged by antitrust law, e.g., obligations regarding the ordinary course of business, clauses of "material effect" and other preparatory measures like staff planning, designing a new reporting system, etc. Having said this, it needs to be noted that the antitrust law practice is not yet completely settled. Basically, a case-by-case examination is required. In particular, there is some discussion whether the coordination of business activities can be an infringement of the prohibition of premature completion of a concentration. As a result, there is only a small path between the need for quick completion of the concentration and the fulfilment of the antitrust law requirements. (THK)

4. Changes in German Arbitration Rules

The German Institution of Arbitration (DIS) has recently made two amendments to its standard rules on arbitration proceedings. Both amendments were accompanied by suggestions for respective arbitration clauses.

"Fast Track" – Proceedings
The Supplementary Rules for Expedited Proceedings limit the period of time between (1) the initiation of proceedings by lodging the statement of claims to the central office of DIS and (2) the arbitration ruling itself to six and nine months respectively. Furthermore, if not agreed otherwise between the parties, the arbitration tribunal consists of one arbitrator. Finally, the tribunal is entitled to impose certain restrictions on the parties regarding deadlines of writs to the tribunal as well as dates and number of oral hearings.

Rules on Corporate Disputes
Further, DIS issued the Supplementary Rules for Corporate Law Disputes. These supplementary rules enable parties to meet the requirements which the German Federal Court of Justice (BGH) established in 2009 in respect of the arbitration of shareholder's resolutions (as reported in our German Law and Business News, May 2010). According to the court, such rules need to provide the same standards for shareholders as to their participation, right to be heard etc. as proceedings in front of state courts do. This is ensured by the new DIS rules.
It was the original intention of DIS that these rules should only apply to corporate law disputes within German entities between the different stakeholders (shareholders, executive bodies, body corporate). Nevertheless, certain provisions may also be chosen by the shareholders in order to apply to disputes within foreign entities, usually in cases where

a foreign entity, e.g. a joint venture, has an influential German shareholder. In such a case, however, the legal implications of choosing the supplementary DIS-rules should be closely reviewed before they are agreed. (JFI)

5. European Parliament Approves „Made in"-Labels

In October 2010 the European Parliament approved new labelling laws that require manufacturers to specify on the product label the country where most of the product was originally made. The new rules apply to a wide range of products imported into the EU and aim at boosting European production and employment levels by increasing the consumption of domestically made products.

The Council of Ministers still needs to give its approval. While states such as Sweden are reluctant, other states like Italy or Spain have pushed for mandatory "made in" labelling in order to decrease growing low-cost imports.

Critics invoke the financial burden the regulation puts on small businesses and the retail industry. Another concern is that the regulation could lead to a decline in the purchase rate of products made under "fair trade" practices as these are not subject to specific rules which require their identification and therefore do not seem to carry the same value statement. (HEJ)

6. European Court of Justice Extends Post-contractual Claims of Commercial Agents Under German Law

Under German law (as harmonized in this regard at a European level), a commercial agent is entitled to compensation after termination of his contractual relationship with the principal, as a remuneration for the customer base acquired to the (lasting) benefit of the principal. Such compensation is only excluded by law under very limited circumstances. The European Court of Justice (ECJ) has now extended the scope of said claims to compensation.

An agent's claim to compensation is excluded under German law, if the principal has terminated the agency agreement prematurely for just and good cause based on the agent's misconduct. According to decisions by the German Federal Court (BGH), such good cause only needs to exist 'objectively' at the time the principal gives notice, but does not have to be the actual reason for the termination. The ECJ now considered such jurisprudence not in conformity with the European directive 86/653/EEC on the harmonisation of the laws of the member states relating to self-employed commercial agents. Rather, the ECJ requires a causal link between the good cause within the responsibility of the agent and the termination by the principal. That ruling is all the more remarkable since the directive 86/653/EEC was derived to a great extent from the German Commercial Code already existing in those days. (MSC)

7. Faultiness of Products due to Missing EC Type Examination Certificate and Deficiencies of the Quality Assurance System

Simply put, under German law a product is regarded to be defective, if its features do not live up to what the parties have contractually agreed upon. In principle, the reference for this comparison is the specific purchase item, i.e. the question whether said item is sufficiently safe or complies with the agreed specifications. The burden of proof for the defectiveness of the purchase item is, thereby, on the buyer's side.

A recent decision of the District Court of Aachen/ Aix-la-Chapelle demonstrates, however, that a product can also be defective – irrespective of its constituency – if a required EC type examination certificate has not been obtained by the manufacturer. In the case at hand, it was only admissible to place the affected products on the market with such a certificate. The District Court has ruled that the missing certificate by itself entitles the purchaser to withdraw from the contract and reclaim the purchase price. The same applies to a declined but required regulatory approval of the quality assurance system of the manufacturer, given that one may suspect that such deficiencies result in product defects.

In sectors where EC type examinations and the approval of the quality assurance system are mandatory, one has to carefully deal with this issue – deficits in this regard may even lead to a ban on sales of the affected products. The importance of such certificates has also been taken into account in case of acquisitions, in particular asset deals: since the respective certificates do not pass on to the buyer automatically, one needs to arrange for a smooth transfer in the process. (GUD)

8. No German Right to Tax the License Payments of a German Partnership to a Foreign Partner

In the event that a partner who is a co-entrepreneur (*Mitunternehmer*) of a German partnership receives income from the partnership in return for acting on its behalf (= technically income from employment), granting a loan (= interest income) or licensing rights to it (= royalties), such income is treated as extra allowance (*Sondervergütungen*) of the partner and re-qualified as business income according to domestic German unilateral tax law. One aspect which has been unclear in this regard over the past years is whether such domestic German tax treatment applies accordingly within the scope of a double taxation agreement ("**DTA**"), i.e. whether extra allowances of a foreign partner (= resident of the other contracting state) are also qualified as business income for DTA purposes, even if they technically constitute income from employment, interest income or royalties.

The German tax authorities have continuously been of the opinion that the domestic German tax treatment of the extra allowances shall generally apply accordingly on the DTA level. Moreover, the German legislator recently implemented a provision in the German Income Tax Act (*Einkommensteuergesetz*) according to which extra allowances shall be treated as business income for DTA purposes unless the respective applicable DTA contains an explicit provision to the contrary. As a consequence, the German tax authorities generally allocated the extra allowances derived by the foreign partner of a German partnership to the domestic permanent establishment created by such partnership, which eventually resulted in a German taxation right regarding the extra allowances.

The German Federal Tax Court (*Bundesfinanzhof = BFH*) now disagreed with the tax authorities' practice at least insofar as royalties derived by a US- corporation from a German partnership are concerned. According to the BFH, Germany has no right of taxation regarding the royalty payments, provided that the licensed rights do not have to be recognised in the tax balance sheet of the German partnership/permanent establishment. Correspondingly, as regularly no such recognition requirement should exist, Germany will frequently have no right to tax the royalty payments. Even though the decision explicitly only refers to royalties, it can be assumed that the BFH statements should also apply to other types of extra allowances (e.g. interest), since from a German tax standpoint the situation is similar in this regard. (GEB)

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