GIBSON DUNN

2019 Year-End German Law Update

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Since the end of World War II, Germany's foreign policy and economic well-being were built on three core pillars: (i) a strong transatlantic alliance and friendship, (ii) stable and influential international institutions and organizations, such as first and foremost, the EU, but also others such as the UN and GATT, and, finally, (iii) the rule of law. Each of these pillars has suffered significant cracks in the last years requiring a fundamental re-assessment of Germany's place in the world and the way the world's fourth largest economy should deal with its friends, partners, contenders and challengers. A few recent observations highlight the urgency of the issue:

- The transatlantic alliance and friendship has been eroding over many years. A recent Civey study conducted for the think tank Atlantic-Brücke showed that 57.6% of Germans prefer a "greater distance" to the U.S., 84.6% of the 5,000 persons polled by Civey described the German-American relationship as negative or very negative, while only 10.4% considered the relationship as positive.
- The current state of many international institutions and organizations also requires substantial overhaul, to put it mildly: After Brexit has occurred, the EU will have to re-define its role for its remaining 27 member states and its (new) relationship with the UK, which is still the fifth-largest economy on a stand-alone basis. GATT was rendered de facto dysfunctional on December 10, 2019, when its Appellate Body lost its quorum to hear new appeals. New members cannot be approved because of the United States' veto against the appointment of new appeal judges. The UN is also suffering from a vacuum created by an attitude of disengagement shown by the U.S., that is now being filled by its contenders on the international stage, mainly China and Russia.
- Finally, the concept of the rule of law has come under pressure for some years through a combination of several trends: (i) the ever expanding body of national laws with extra-territorial effect (such as the FCPA or international sanction regulations), a rule-making trend not only favored by the U.S., but also by China, Russia, the EU and its member states alike, (ii) the trend – recently observed in some EU member states – that the political party in charge of the legislative and executive branch initiates legislative changes designed to curtail the independence of courts (e.g. Poland and Hungary), and (iii) the rise of populist parties that have enjoyed land-slide gains in many countries (including some German federal states) and promulgate simple solutions, not least by cutting corners and curtailing legal procedures and legal traditions.

These fundamental challenges occur toward the end of a period of unprecedented rise in wealth and economic success of the German economy: Germany has reaped the benefits of eight decades of peace and the end of the Cold War after the decay of the Soviet Union. It regained efficiencies after ambitious structural changes to its welfare state in the early years of the millennium, and it re-emerged as a winner from the 2008 financial crisis benefiting (among others) from the short-term effects of the European Central Bank's policy of a cheap Euro that mainly benefits the powerful German export machine (at the mid- and long-term cost to German individual savers).

The robust economy that Germany enjoyed over the last decade resulted in record budgets, a reduction of public debt, a significant reduction in unemployment, and individual

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consumption at record levels. Therefore, the prospects of successfully addressing the above challenges are positive. However, unless straight forward and significant steps are identified and implemented to address the challenges ahead, the devil will be in the detail. The legislative changes across all practice areas covered in this year-end update are partly encouraging, partly disappointing in this respect.

It is impossible to know whether the new laws and regulations will, on balance, make Germany a stronger and more competitive economy in 2020 and beyond. Healthy professional skepticism is warranted when assessing many of the changes suggested and introduced. However, we at Gibson Dunn are determined and committed to ensuring that we utilize the opportunities created by the new laws to the best benefit of our clients, and, at the same time, helping them in their quest to limit any resulting threats to the absolute minimum.

As in prior years, in order to succeed in that, we will require your trust and confidence in our ability to support you in your most complicated and important business decisions and to help you form your views and strategies to deal with sophisticated German legal issues in times of fundamental change.

Your real-world questions and the tasks you entrust us with related to the above developments and changes help us in forming our expertise and sharpening our focus. This adds the necessary color that allows us to paint an accurate picture of the multifaceted world we are living in, and on this basis, it will allow you to make sound business decisions in the interesting times to come. In this context, we are excited about every opportunity you will provide us with to help shaping our joint future in the years to come.

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1. Corporate, M&A

1.1 ARUG II – New Transparency Rules for Listed German Corporations, Institutional Investors, Asset Managers, and Proxy Advisors

In November 2019, the German parliament passed *ARUG II*, a long awaited piece of legislation implementing the revised European Shareholders' Rights Directive (Directive (EU) 2017/828). *ARUG II* is primarily aimed at listed German companies and provides changes with respect to "say on pay" provisions, as well as additional approval and disclosure requirements for related party transactions, the transmission of information between a corporation and its shareholders and additional transparency and reporting requirements for institutional investors, asset managers and proxy advisors.

"Say on pay" on remuneration of board members; remuneration policy and remuneration report

In a German stock corporation, shareholders determine the remuneration of the supervisory board members at a shareholder meeting, whereas the remuneration of the management board members is decided by the supervisory board. Under *ARUG II*, shareholders of German listed companies must be asked to vote on the remuneration of the board members pursuant to a prescribed procedure. *First*, the supervisory board will have to prepare a detailed remuneration policy (including maximum remuneration amounts) for the management board, which must be submitted to the shareholders if there are major changes to the remuneration, and in any event at least once every four years. The result of the vote on the policy will only be advisory except that the shareholders' vote to reduce the maximum remuneration amount will be binding. With respect to the remuneration of supervisory board members, the new rules require a shareholder vote at least once every four years. *Second*, at the annual shareholders' meeting, the shareholders will vote ex post on the remuneration report which contains the remuneration granted to the present and former members of the management board and the supervisory board in the previous financial year. Again, the shareholders' vote, however, will only be advisory. Both the remuneration report and the remuneration policy have to be made public on the company's website for at least ten years.

The changes introduced by *ARUG II* will not apply retroactively and will not therefore affect management board members' existing service agreements, i.e. such agreements will not have to be amended in case they do not comply with the new remuneration policy.

Related party transactions

German stock corporation law already provides for various safeguards to protect minority shareholders in transactions with major shareholders or other related parties (e.g. the capital maintenance rules and the laws relating to groups of companies). In the future, for listed companies, these mechanisms will be supplemented by a detailed set of approval and transparency requirements for related party transactions. In particular, transactions exceeding certain thresholds will require prior supervisory board approval, provided that a rejection by the supervisory board can be overruled by shareholder vote, and a listed company must publicly disclose any such material related party transaction, without undue delay over media channels providing for European-wide distribution.

Communication / Know-your-Shareholder

Listed corporations will have the right to request information on the identity of their shareholders, including the name and both a postal and electronic address, from depositary banks, thus allowing for a direct communication line, also with respect to bearer shares ("know-your-shareholder"). Furthermore, depositary banks and other intermediaries will be required to pass on important information from the corporation to the shareholders and vice versa, e.g. with respect to voting in shareholders' meetings and the exercise of subscription rights. Where there is more than one intermediary in a chain, the intermediaries are required to pass on the respective information within the chain.

Increased transparency requirements for institutional investors, asset managers and proxy advisors

Institutional investors and asset managers will be required to disclose their engagement policy (including how they monitor, influence and communicate with investee companies, exercise shareholders' rights and manage actual and potential conflicts of interests). They will also have to report annually on the implementation of their engagement policy and on their voting decisions. Institutional investors will also have to disclose to which extent key elements of their investment strategy match the profile and duration of such institutional investors' liabilities towards their ultimate beneficiaries. If they involve asset managers, institutional investors also have to disclose the main aspects of their arrangements with them. The new disclosure and reporting requirements, however, only apply on a "comply or explain" basis, i.e. investors and asset managers may choose not to comply with the transparency requirements provided that they give an explanation as to why this is the case.

Proxy advisors will have to publicly disclose on an annual basis whether and how they have applied their code of conduct based again on the "comply or explain" principle. They also have to provide information on the essential features, methodologies and models they apply, their main information sources, the qualification of their staff, their voting policies for the different markets they operate in, their interaction with the companies and the stakeholders as well as how they manage conflicts of interests. These rules, however, do not apply to proxy advisors operating from a non-EEA state with no establishment in Germany.

Entry into force and transitional provisions

The provisions concerning related party transactions already apply. The rules relating to communications via intermediaries and know-your-shareholder information will apply from September 3, 2020. The "mandatory say on pay" resolutions will only have to be passed in shareholder meetings starting in 2021. The remuneration report will have to be prepared for the first time for the financial year 2021. It needs to be seen whether companies will already adhere to the new rules prior to such dates on a voluntary basis following requests from their shareholders or pressure from proxy advisors. In any event, both listed companies as well as the other addressees of the new transparency rules should make sure that they are prepared for the new reporting and disclosure requirements.

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1.2 Restatement of the German Corporate Governance Code – New Stipulations for the Members of the Supervisory Board and the Remuneration of the Members of the Board of Management

A restatement of the German Corporate Governance Code (*Deutscher Corporate Governance Kodex,* "**DCGK**" or the "**Code**") is expected for the beginning of 2020, after the provisions of the EU Shareholder Rights Directive II (Directive (EU) 2017/828 of the European Parliament and of the Council of May 17, 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement) were implemented into German domestic law as part of the "ARUG II" reform as of January 1, 2020. This timeline seeks to avoid overlaps and potentially conflicting provisions between ARUG II and the Code.

In addition to structural changes, which are designed to improve legal clarity compared to the previous 2017 version, the new Code contains a number of substantial changes which affect boards of management and supervisory boards in an effort to provide more transparency to investors and other stakeholders. Some of the key modifications can be summed up as follows:

> (a) Firstly, restrictions on holding multiple corporate positions are tightened considerably. The new DCGK will recommend that (i) supervisory board members should hold no more than five supervisory board mandates at listed companies outside their own group, with the position of supervisory board chairman being counted double, and (ii) members of the board of management of a listed company should not hold more than two supervisory board mandates or comparable functions nor chair the supervisory board of a listed company outside their own group.

(b) A second focal point is the independence of shareholder representatives on the supervisory board. In this context, the amended DCGK for the first time introduces certain criteria which can indicate a lack of independence by supervisory board members such as long office tenure, prior management board membership, family or close business relationships with board members and the like. However, the Government Commission DCGK (*Regierungskommission Deutscher Corporate Governance Kodex*) (the "**Commission**") has pointed out that these criteria should not replace the need to assess each case individually.

Furthermore, at least 50% of all shareholder representatives (including the chairperson) shall be independent. If there is a controlling shareholder, at least two members of the supervisory board shall be independent of such controlling shareholder (assuming a supervisory board of six members).

(c) A third key area of reform focuses on the remuneration of members of the board of management. Going forward, it is recommended that companies should determine a so-called "target total remuneration", i.e. the amount of remuneration that is paid out in total if 100 percent of all previously determined targets have been achieved, as well as a "maximum compensation cap", which should not be exceeded even if the previously determined targets are exceeded. Under the new Code, the total remuneration of the management board should be "explainable to the public".

(d) Finally, the Commission has decided to simplify corporate governance reporting and put an end to the parallel existence of (i) the corporate governance report under the Code and (ii) a separate corporate governance statement contained in the management report of the annual accounts. Going forward, the corporate governance statement in the annual financial statements will be the core instrument of corporate governance reporting.

In recent years, governance topics have assumed ever increasing importance for both domestic and foreign investors and are typically a matter of great interest at annual shareholders' meetings. Hence, we recommend that (listed) stock corporations, in a first step, familiarize themselves with the content of the new recommendations in the Code and, thereafter, take the necessary measures to comply with the rules of the revised DCGK once it takes effect . In particular, stock corporations should evaluate and disclose the different mandates of their current supervisory board members to comply with the new rules.

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1.3 Cross-Border Mobility of European Corporations Facilitated

On January 1, 2020 the European Union Directive on cross-border conversions, mergers and divisions (Directive (EU) 2019/2121 of the European Parliament and of the Council of November 27, 2019) (the "**Directive**") has entered into force.

While a legal framework for cross-border mergers had already been implemented by the European Union in 2005, the lack of a comparable set of rules for cross-border conversions and divisions had led to fragmentation and considerable legal uncertainty. Whenever companies, for example, attempted to move from one member state to another without undergoing national formation procedures in the new member state and liquidation procedures in the other member state, they were only able to rely on certain individual court rulings of the European Court of Justice (ECJ). Cross-border asset transfers by (partial) universal legal succession ((*partielle) Gesamtrechtsnachfolge)* were virtually impossible due to the lack of an appropriate legal regime. The Directive now seeks to create a European Union-wide legal framework which ultimately enhances the fundamental principle of freedom of establishment (*Niederlassungsfreiheit*).

The Directive in particular covers the following cross-border measures:

- The conversion of the legal structure of a corporation under the regime of one member state into a legal structure of the destination member state (*grenzüberschreitende Umwandlung*) as well as the transfer of the registered office from one member state to another member state (*isolierte Satzungssitzverlegung*);
- Cross-border division whereby certain assets and liabilities of a company are transferred by universal legal succession to one or more entities in another member state which are to be newly established in the course of the division. If all assets and liabilities are transferred, at least two new transferee companies are required and the transferor company ceases to exist upon effectiveness of the division. In all cases, the division is made in exchange for shares or other interests in the transferor company, the transferee company or their respective shareholders, depending on the circumstances.
- The Directive further amends the existing legal framework for cross-border merger procedures by introducing common rules for the protection of creditors, dissenting minority shareholders and employees.
- Finally, the Directive provides for an anti-abuse control procedure enabling national authorities to check and ultimately block a cross-border measure when it is carried out for abusive or fraudulent reasons or in circumvention of national or EU legislation.

Surprisingly, however, the Directive does not cover a cross-border transfer of assets and liabilities to one or more companies already existing in another member state (*Spaltung durch Aufnahme*). In addition, the Directive only applies to corporations (*Kapitalgesellschaften*) but not partnerships (*Personengesellschaften*). Member states have until January 2023 to implement the Directive into domestic law.

Through this legal framework for corporate restructuring measures, it is expected that the Directive will harmonize the interaction between national procedures. If the member states do not use the contemplated national anti-abuse control procedure excessively, the Directive can considerably facilitate cross-border activities. Forward looking member states may even consider implementing comparable regimes for divisions into existing legal entities which are currently beyond the scope of the Directive.

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1.4 Transparency Register: Reporting Obligations Tightened and Extended to Certain Foreign Entities

The Act implementing the 5th EU Anti-Money Laundering Directive (Directive (EU) 2018/843) which amended the German Anti-Money Laundering Act (*Geldwäschegesetz*, *GwG*) with effect as of January 1, 2020 (see below under section 6.2) also introduced considerable new reporting obligations to the transparency register (*Transparenzregister*), which seeks to identify the “ultimate beneficial owner”.

Starting on January 1, 2020, not only associations incorporated under German private law, but also foreign associations and trustees that have a special link to Germany must report certain information on their „beneficial owners“ to the German transparency register. Such link exists if foreign associations acquire real property in Germany. Non-compliance is not only an administrative offence (potential fines of up to EUR 150,000), but the German notary recording a real estate transaction must now check actively that the reporting obligation has been fulfilled before notarizing such transaction and must refuse notarization if it has not.

Foreign trustees must in addition report the beneficial owners of the trust if a trust acquires domestic real property or if a contractual partner of the trust is domiciled in Germany. Reporting by a foreign association or trustee to the German transparency register is, however, not required if the relevant information on the beneficial owners has already been filed with a register of another EU member state. Additional requirements apply to foreign trustees.

In addition, the reporting obligations of beneficial owners, irrespective of their place of residence, towards a German or, as the case may be, foreign association, regarding their interest have been clarified and extended. Associations concerned must now also actively make inquiries with their direct shareholders regarding any beneficial owners and must keep adequate records of these inquiries. Shareholders must respond to such inquiries within a reasonable time period and, in addition, must also notify the association pro-actively, if they become aware that the beneficial owner has changed as well as duly record any such notification.

Furthermore, persons or entities subject to the GwG obligations ("**Obliged Persons**") inspecting the transparency register to fulfil their customer due diligence requirements (e.g. financial institutions and estate agents) must now notify the transparency register without undue delay of any discrepancies on beneficial ownership between entries in the register and other information and findings available to them.

Finally, the transparency register is now also accessible to the general public without proof of legitimate interest with regard to certain information about the beneficial owner (full legal name of the beneficial owner, the month and year of birth, nationality and country of residence as well as the type and extent of the economic interest of the beneficial owner). As in the past, however, the registry may restrict inspection into the transparency register, upon request of the beneficial owner, if there are overriding interests worthy of protection. In return for any disclosure, starting on July 1, 2020, beneficial owners may request information on inspections made by the general public (in contrast to inspections made by public authorities or Obliged Persons such as, e.g. financial institutions, auditing firms, or tax consultants and lawyers).

Although reporting obligations to the transparency register were initially introduced more than 2.5 years ago, compliance with these obligations still seems to be lacking in practice. Therefore, any group with entities incorporated in Germany, any foreign association intending to acquire German real estate and any individual qualifying as a beneficial owner of a domestic or foreign association should check whether new or outstanding inquiry, record keeping or reporting obligations arise for them and take the required steps to ensure compliance.

In this context, we note that for some time now the competent administrative enforcement authority (*Bundesverwaltungsamt*) has increased its efforts to enforce the transparency obligations, including imposing fines on associations that have failed to make required filings. It is to be expected that they will further tighten the reins based on this reform.

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1.5 UK LLPs with Management Seat in Germany – Status after Brexit?

As things stand at present the British government is pushing to enact its Withdrawal Agreement Bill (the "**WAB**") to ensure that it can take the UK out of the EU on January 31, 2020. Pursuant to the WAB such withdrawal from the EU is not intended to result in a so-called "Hard Brexit" as the WAB introduces a transition period until December 31, 2020 during which the European fundamental freedoms including the freedom of establishment would continue to apply.

Freedom of establishment has, over the last decade in particular, resulted in German law recognizing that UK (and other EU) companies can have their effective seat of management (*Verwaltungssitz*) in Germany rather than the respective domestic jurisdiction. Until the end of the transition period, UK company structures such as UK Plc, Ltd. or LLP will continue to benefit from such recognition.

But what happens thereafter if the EU and the UK (or, alternatively, Germany and the UK) do not succeed in negotiating particular provisions for the continued recognition of UK companies in the EU or Germany, respectively? From a traditional German legal perspective, such companies will lose their legal capacity as a UK company in Germany after the transition period because German courts traditionally follow the real or effective seat theory (*Sitztheorie*) and thus apply German corporate law to the companies in question rather than the incorporation theory (*Gründungstheorie*) which would lead to the application of English law.

There would be a real risk that UK companies that have their effective management seat in Germany would have to be reclassified as a German company structure under the *numerus clausus* of German company structures. For some company structures such as the "LLP" German law does not have an equivalent LLP company structure as such, and reclassifying it as a German law limited partnership would not work either in most cases due to lack of registration in the German commercial register. In short, the only alternative for future recognition of a UK multi-person LLP, under German law, may be a German civil law partnership (*GbR*) or in certain cases a German law commercial partnership (*OHG*), with all legal consequences that flow from such structures, including, in particular, unlimited member liability. The discussion on how to resolve this issue in Germany has focused on a type of German partnership with limited liability (*Partnerschaftsgesellschaft mit beschränkter Haftung*, *PartGmbB*), that has only limited scope. A PartGmbB is only open to members of the so-called liberal or free professions such as attorneys or architects. In addition, the limitation of liability in a PartGmbB applies only to liability due to professional negligence and risks associated with the profession, and would thus not benefit their members generally.

Unless UK companies with an effective seat of management in Germany opted to risk reliance on the status quo – in the event there is no new framework for recognition after the transition period – affected companies should either change their seat of management to the UK (or any other EU jurisdiction that applies the incorporation theory) and establish a German branch office, or, alternatively, consider forming a suitable German legal corporate structure before the end of the transition period at the end of December 2020.

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1.6 The ECJ on Corporate Agreements and the Rome I Regulation

In its decision C-272/18, of 3 October 2019, the European Court of Justice (*ECJ*) further clarified the scope of the EU regulation Rome I (Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (the "**Rome I Regulation**") on the one hand, and international company law which is excluded from the scope of the Rome I Regulation on the other hand. The need for clarification resulted from Art. 1 para. 2 lit f. of the Rome I Regulation pursuant to which "questions governed by the law of companies and other bodies, corporate or unincorporated, such as the creation, by registration or otherwise, legal capacity, internal organization or winding-up of companies and other bodies […]" are excluded from the scope of the Rome I Regulation.

The ECJ, as the highest authority on the interpretation of the Regulation, held that the "corporate law exception" does not apply to contracts which have shares as object of such contract only. According to the explicit statement of the Advocate General Saugmandsgaard Øe, this also includes share purchase agreements which are now held to be within the scope of the Rome I Regulation. This exception from the scope of the Rome I Regulation is thus much narrower than it has been interpreted by some legal commentators in the past.

The case concerned a law suit brought by an Austrian consumer protection organization ("**VKI**") against a German public instrument fund ("**TVP**"), and more particularly, trust arrangements for limited (partnership) interests in funds designed as public limited partnerships. The referring Austrian High Court had to rule on the validity of a choice of law clause in trust agreements concerning German limited partnership interests between the German fund TVP, as trustee over the investors' partnership interests, and Austrian investors qualifying as consumers, as trustors. This clause provided for the application of German substantive law only.

VKI claimed that this clause was, under Austrian substantive law, not legally effective and binding because pursuant to the Rome I Regulation, a contract concluded by a consumer with another person acting in the exercise of his/her trade or profession shall either be governed by the law of the country of the consumer's habitual residence (in this case Austria) and/or, in the event the parties have made a choice as to the applicable law, at least not result in depriving the consumer of the protection offered to him/her by his/her country of residence. The contractual choice of German law could not therefore, in VKI's view, deprive Austrian investors of rights guaranteed by Austrian consumer protection laws. TVP, on the other hand, argued that the Rome I Regulation was not even applicable as the contract in question was an agreement related to partnership interests and, thus, to corporate law which was excluded from the scope of the Rome I Regulation.

The ECJ ruled that the relevant corporate law exclusion from the scope of the Rome I Regulation is limited to the organizational aspects of companies such as their incorporation or internal statutes. In turn, a mere connection to corporate law was ruled not to be sufficient to fall within the exclusion. Sale and purchase agreements in M&A transactions, or as in the matter at hand trust arrangements, are therefore covered by the Rome I Regulation.

The decision provides that the choice of law principle of the Rome I Regulation is, subject to the restrictions imposed by the Regulation itself for particular groups such as consumers and employees, applicable in more cases than considered in the past with respect to corporate law related contracts.

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1.7 German Foreign Direct Investment – Further Rule-Tightening Announced for 2020

Restrictions on foreign investment is increasingly becoming a perennial topic. After the tightening of the rules on foreign direct investment in 2017 (see 2017 Year-End German Law Update under 1.5) and the expansion of the scope for scrutiny of foreign direct investments in 2018 (see 2018 Year-End German Law Update under 1.3), the German Ministry of Economy and Energy (*Bundesministerium für Wirtschaft und Energie*) in November 2019 announced further plans to tighten the rules for foreign direct investments in Germany in its policy guideline on Germany's industrial strategy 2030 (*Industriestrategie 2030 – Leitlinien für eine deutsche und europäische Industriepolitik*).

The envisaged amendments to the German Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung, AWV*) relate to the following three key pillars:

Firstly, by October 2020, the German rules shall be adapted to reflect the amended EU regulations (so-called EU Screening Directive dated March 19, 2019). This would be achieved, *inter alia*, by implementing a cooperation mechanism to integrate other EU member states as well as the EU Commission into the review process. Further, the criteria for public order or security (*öffentliche Ordnung oder Sicherheit*) relevant to the application of foreign trade law is expected to be revised and likely expanded to cover further industry sectors such as artificial intelligence, robotics, semiconductors, biotechnology and quantum technology. The threshold for prohibiting a takeover may be lowered to cover not only a "threat" but a "foreseeable impairment" of the public order or security (as contemplated in the EU directive).

Secondly, if the rules on foreign direct investments cannot be relied on to block an intended acquisition, but such acquisition nonetheless affects sensitive or security related technology, another company from the German private sector may acquire a stake in the relevant target as a so-called "White Knight" in a process moderated by the government.

Thirdly, as a last resort, the strategy paper proposes a "national fallback option" (*Nationale Rückgriffsoption*) under which the German state-owned *Kreditanstalt für Wiederaufbau* could acquire a stake in enterprises active in sensitive or security-related technology sectors for a limited period of time.

Even though the details for the implementation of those proposals are not yet clear, the trend towards more protectionism continues. For non-EU investors a potential review pursuant to the rules on foreign direct investment will increasingly become the new rule and should thus be taken into account when planning and structuring M&A transactions.

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2. Tax - German Federal Government Implements EU Mandatory Disclosure Rules

On December 12, 2019 and December 20, 2019, respectively, the two chambers of the German Federal Parliament passed the *Law for the Introduction of an Obligation to report Cross-Border Tax Arrangements* (the "**Law**"), which implements Council Directive 2018/822/EU (referred to as "**DAC 6**") into Germany's domestic law effective as of July 1, 2020.

DAC 6 entered into force on June 25, 2018 and requires so-called intermediaries, and in some cases taxpayers, to report cross-border arrangements that contain defined characteristics with their national tax authorities within specified time limits. The stated aim of DAC 6 is to provide tax authorities with an early warning mechanism for new risks of tax avoidance.

The Law follows the same approach as provided for in DAC 6. The reporting obligation would apply to "cross-border tax arrangements" in the field of direct taxes (e.g. income taxes but not VAT). Cross-border arrangements concern at least two member states or a member state and a non-EU country. Purely national German arrangements are - contrary to previous drafts of the Law – not subject to reporting.

> (a) Reportable cross-border arrangements must have one or more specified characteristics ("hallmarks"). The hallmarks are broadly scoped and represent certain typical features of tax planning arrangements, which potentially indicate tax avoidance or tax abuse.
>
> (i) Some of these hallmarks would result in reportable transactions only if the "main benefit test" is satisfied. The test would be satisfied if it can be established that the main benefit that a person may reasonably expect to derive from an arrangement is obtaining a tax advantage in Germany or in another member state.

Hallmarks in that category are, inter alia, the use of substantially standardized documentation or structures, the conversion of income into lower taxed categories of revenue or payments to an associated enterprise that are tax exempt or benefit from a preferential tax regime or arrangement.

(ii) In addition, there are hallmarks that would result in reportable transactions regardless of whether the main benefit test is satisfied. Hallmarks in this category are, for example, assets that are subject to depreciation in more than one jurisdiction, relief from double taxation that is claimed more than once, arrangements that involve hard-to-value intangibles or specific transfer pricing arrangements.

(b) The primary obligation to disclose information to the tax authorities rests with the intermediary. An intermediary is defined as “any person that promotes, designs for a third party, organizes, makes available for implementation or manages the implementation of a reportable cross-border arrangement.” Such intermediary must be resident in the EU or provides its services through a branch in the EU.

Typical intermediaries are tax advisors, accountants, lawyers, financial advisors, banks and consultants. When multiple intermediaries are engaged in a cross-border arrangement, the reporting obligation lies with all intermediaries involved in the same arrangement. However, an intermediary can be exempt from reporting if he can prove that a report of the arrangement has been filed by another intermediary.

In the event an intermediary is bound by legal professional privilege from reporting information, the intermediary would have to inform the relevant taxpayer of the possibility of waiving the privilege. If the relevant taxpayer does not grant the waiver, the responsibility for reporting the information would shift to the taxpayer. Other scenarios where the reporting obligation is shifted to the taxpayer are in-house schemes without involvement of intermediaries or the use of intermediaries from countries outside the EU.

(c) Reporting to the tax office is required within a 30-day timeframe after the arrangement is made available for implementation or when the first step has been implemented. The report must contain the applicable hallmark, a summary of the cross-border arrangement including its value, the applicable tax provisions and certain information regarding the intermediary and the taxpayer. The information will be automatically submitted by the competent authority of each EU member state through the use of a central directory on administrative cooperation in the field of direct taxation.

(d) The reporting obligations commence on July 1, 2020. However, the Law also has retroactive effect: for all reportable arrangements that were implemented in the interim period between June 24, 2018 and June 30, 2020 the report would have to be filed by August 31, 2020.

Penalties for noncompliance with the reporting obligations are up to EUR 25,000 while there are no penalties for noncompliance with such reportable arrangements for the interim period between June 25, 2018 and June 30, 2020.

Since, as noted above, the reporting obligation can be shifted to the client as the taxpayer and the client will then be responsible for complying with the reporting obligations, taxpayers should consider establishing a suitable reporting compliance process. Such process may encompass sensitization for and identification of reportable transactions, the determination of responsibilities, the development of respective DAC 6 governance and a corresponding IT-system, recording of arrangements during the transitional period after June 24, 2018, robust testing and training as well as live operations including analysis and reporting of potential reportable arrangements.

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3. Financing and Restructuring

3.1 EU Directive on Preventive Restructuring Framework – Minimum Standards Across Europe?

On June 26, 2019, the European Union published Directive 2019/1023 on a preventive restructuring framework *(Directive (EU) 2019/1023 of the European Parliament and of the Council of June 20, 2019)* (the "**Directive**"). The Directive aims to introduce standards for "honest entrepreneurs" in financial difficulties providing businesses with a "second chance" in all EU member states.

While some member states had already introduced preventive restructuring schemes in the past (e.g. the UK scheme of arrangement), others, like Germany, stayed inactive, leaving debtors with the largely creditor-focused and more traditional tools set forth in the German Insolvency Code (*Insolvenzordnung*, *InsO*). By contrast, the Directive now seeks to protect workers and creditors alike in "a balanced manner". In addition, a particular focus of the Directive are small and medium-sized enterprises, which often do not have the resources to make use of already existing restructuring alternatives abroad.

The key features of the Directive provide, in particular:

- The preventive restructuring regime shall be available upon application of the debtor. Creditors and employee representatives may file an application, but generally the consent of the debtor shall be required in addition;
- Member states are required to implement early warning tools and to facilitate access to information enabling debtors to properly assess their financial situation early on and detect circumstances which may ultimately lead to insolvency;
- Preventive restructuring mechanisms must be set forth in domestic law in the event there is a "likely insolvency". Debtors must be given the possibility to remain in control of the business operations while restructuring measures are implemented to avoid formal insolvency proceedings. In Germany, it will be a challenge to properly distinguish between the newly introduced European concept of "likely insolvency" which is the door opener for preventive restructuring under the Directive and the existing German legal concept of "imminent illiquidity" (*drohende Zahlungsunfähigkeit)* which under current insolvency law enables German debtors to proceed with a voluntary insolvency filing;
- A stay of individual enforcement measures for an initial period of four months (with an extension option of up to a maximum of 12 months) must be provided for, thus putting debtors in a position to negotiate a restructuring plan. During this time period, the performance of executory contracts cannot be withheld solely due to non-payment;
- Minimum requirements for a restructuring plan include an outline of the contemplated restructuring measures, effects on the workforce, as well as the prospects that insolvency can be prevented on the basis of such measures;
- Restructuring measures contemplated by the Directive are wide ranging and include a change in the composition of a debtor's assets and liabilities, a sale of assets or of the business as a going concern, as well as necessary operational changes;
- Voting on the restructuring plan is generally effected by separate classes of creditors in each case with a majority requirement of not more than 75%.

- Cross-class cram down will be available subject to certain conditions including (i) a majority of creditor classes (including secured creditors) voted in favor and (ii) dissenting creditors are treated at least equal to their pari passu creditors (or better than creditors ranking junior). In addition, the restructuring plan must be approved by either a judicial or administrative authority in order to be binding on dissenting voting classes. Such approval is also required in the event of new financing or when the workforce is reduced by more than 25%.

Member states have until July 17, 2021 to implement the Directive into domestic law (subject to a possible extension of up to one year), but considering the multiple alternative options the Directive leaves to member states, discussions on how to best align existing domestic laws with the requirements of the Directive have already started.

Ultimately, the success of the Directive depends on the willingness of the member states to implement a truly effective pre-insolvency framework. The inbuilt flexibility and variety of structuring alternatives left to the member states can be an opportunity for Germany to finally enact an out-of-court restructuring scheme beyond the existing debtor in possession (*Eigenverwaltung*) or protective shield (*Schutzschirm*) proceedings which, however, currently kick in only at a later stage of financial distress after an insolvency filing has already been made.

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3.2 Insolvency Contestation in Cash Pool Scenarios

One of the noticeable developments in the year 2019 was that inter-company cash-pool systems have increasingly come under close scrutiny in insolvency scenarios. There were several decisions by the German Federal Supreme Court (*Bundesgerichtshof, BGH*), the most notable one probably a judgment handed down on June 27, 2019 (case IX ZR 167/18) in a double insolvency case where the respective insolvency administrators of an insolvent group company and its insolvent parent and cash pool leader were fighting over the treatment of mutually granted upstream and downstream loans during the operation of a group-wide cash management system that saw multiple loan movements between the two insolvent debtors during the relevant pre-insolvency period.

Under applicable German insolvency contestation laws (*Insolvenzanfechtung*), the insolvency administrator of the insolvent subsidiary has the right to contest any shareholder loan repayments or equivalent payments made to its parent as shareholder and pool leader within a period of one year prior to the point in time when the insolvency filing petition is lodged. The rationale of this rule is to protect the insolvent estate and regular unsecured trade creditors from pre-insolvency payments to shareholders who in an insolvency would only be ranked as subordinated creditors. The contestation right – if successful - allows the insolvency administrator to claw back from shareholders such earlier repayments to boost the funds available for distribution in the insolvency proceedings.

In cases such as the one at hand where the cash pool was operated in a current account system resulting in multiple cash payments to and from the pool leader, the parent's potential exposure could have grown exponentially if the insolvency administrator of the subsidiary could have simply added up all loan repayments made within the last year, irrespective of the fact that the pool leader, in turn, regularly granted new down-stream loan payments to the subsidiary as and when liquidity was needed.

In one of the main conclusions of the judgment, the *BGH* confirmed the calculation mechanism for the maximum amount that can be contested and clawed back in scenarios such as this: The court, in this respect, does not simply add up all loan repayments in the last year. Instead, it uses the historic maximum amount of the loans permanently repaid within the one-year contestation period as initial benchmark and then deducts the outstanding amounts still owed by the insolvent subsidiary at the end of the contestation period. Interim fluctuations, where further repayments to the pool leader occurred, are deemed immaterial if they have been re-validated by new subsequent downstream loans. Consequently, the court limits the exposure of the pool leader in current account situations to the balance of loans, not by way of a simple addition of all repayments.

In a second clarification, the *BGH* decreed that customary, arm's length interest charged by the pool leader to the insolvent subsidiary for its downstream loans and then paid to the shareholder as pool leader are not qualified as a "payment equivalent to a loan repayment", because interest is an independent compensation for the downstream loan, not capital transferred to the lender for temporary use.

Beyond the specifics of the decision, the increased focus of the courts on cash pools in crisis situations should cause larger groups of companies that operate such group-wide cash management systems to revisit the underlying contractual arrangements to ensure that participating companies and the pool leader have adequate mutual early warning systems in place, as well as robust remedies and/or withdrawal rights to react as early as possible to the deterioration of the financial position of one or several cash pool participants. Even though the duration of the one-year contestation period will often mean that even carefully and appropriately drafted cash pooling documentation cannot always preempt or avoid all risk in a later financial crisis, at least, the potential personal liability risks for management which go beyond the mere contestation risk can be mitigated and addressed this way.

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4. Labor and Employment

4.1 De-Facto Employment – A Rising Risk for Companies

A widely-noticed court decision by the Federal Social Court (*Bundessozialgericht*) (judgment of June 4, 2019 – B12 R11 11/18 R) on the requalification of freelancers as de-facto employees has potentially increased risks to companies who employ freelancers.

In this decision, the court requalified physicians officially working as "fee doctors" in hospitals as de-facto employees, because they were considered as integrated into the hospital hierarchy, especially due to receiving instructions from other doctors and the hospital management. While this decision concerned physicians, it found wide interest in the general HR community, as it tightened the leeway for employing freelancers. This aspect is particularly important for companies in Germany, as there is a war for talent, particularly with respect to engineers and IT personnel. These urgently sought-after experts are in high demand and therefore often able to dictate the contractual relationships. In this respect, they often prefer a freelancer relationship, as it is more profitable for them and gives them the opportunity to also work for other (even competing) companies.

Against the background of this decision, every company would be well advised to review very thoroughly, whether a "freelancer" is really free of instructions regarding the place of work, the working hours, and the details of the work to be done. Otherwise, the potential liability for the company – both civil and criminal – is considerable if freelancers are deemed to be de-facto employees.

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4.2 New Constraints for Post-Contractual Non-Compete

Covenants

A recently published decision by the Higher District Court (*Oberlandesgericht*) of Munich has restricted the permissible scope of post-contractual non-compete covenants for managing directors (decision of August 2, 2018 – 7 U 2107/18). The court held that such restrictions are only valid if and to the extent they are based upon a legitimate interest of the company. In addition, their scope has to be explicitly limited in the respective wording tailored to the individual case.

This court decision is important, because, unlike for "regular" employees, post-contractual non-compete agreements for managing directors are not regulated by statutory law. Therefore, every company should, in a first step, carefully review whether a post-contractual non-compete is really necessary for the relevant managing director. If it is deemed to be indispensable, the wording should be carefully drafted according to the above-mentioned principles.

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4.3 ECJ Judgments on Vacation and Working Hours

The European Court of Justice (*ECJ*) has handed down two employee-friendly decisions regarding (a) the forfeiture of entitlement to vacation and (b) the control of working hours (case C-684/16, judgment of November 6, 2018 and case C-55/18, judgment of May 14, 2019).

According to the first decision, employee vacation entitlement cannot simply be forfeited due to the lapse of time, even if such a forfeiture is stipulated by national statutory law. Rather, the employer has an obligation to actively notify employees of their outstanding entitlement to vacation and encourage them to take their remaining vacation.

In the other decision, the ECJ demanded that the company establish a system to control and document all the working hours of its employees, not only those exceeding a certain threshold.

In practical terms of the German economy, not all companies currently have such seamless time control and documentation systems in place. However, until this ECJ judgment is implemented into German statutory law, companies cannot be fined solely based upon the ECJ judgment. Thus, a legislative response to this issue and the court decision must be awaited.

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5. Real Estate

5.1 Real Estate – Rent Price Cap concerning Residential Space in Berlin

On November 26, 2019, the Berlin Senate (the government of the federal state of Berlin) passed a draft bill for the "Act on Limiting Rents on Berlin's Residential Market" (*Gesetz zur Mietenbegrenzung im Wohnungswesen in Berlin*), the so-called Berlin rent price cap (*Mietendeckel*). It is expected that this bill will be adopted by the Berlin House of Representatives (the legislative chamber of the federal state of Berlin) and come into force in early 2020, with certain provisions of the bill having retroactive effect as of June 18, 2019.

This bill shall apply to residential premises in Berlin (with a few exceptions) that were ready for occupancy for the first time before January 1, 2014. The three key instruments of this bill are (a) a rent freeze, (b) the implementation of rent caps and (c) a limit on modernization costs that can be passed on to the tenant.

(a) The rent freeze shall apply to all existing residential leases and shall freeze the rent at the level of the rent on June 18, 2019 (or, if the premises were vacant on that date, the last rent before that date). This rent freeze also applies to indexed rents and stepped rents. As of 2022, landlords shall be entitled to request an annual inflation related rent adjustment, however, capped at 1.3% p.a.. Prior to entering into a new residential lease agreement, the landlord must inform the future tenant about the relevant rent as at June 18, 2019 (or earlier, as applicable).

(b) Depending on the construction year and fit-out standards (with / without collective heating / bathroom), initial monthly base rent caps between EUR 3.92 and EUR 9.80 per square meter (m^2) shall apply. These caps shall be increased by 10% for buildings with up to two apartments. Another increase of EUR 1 per m^2 shall apply with respect to an apartment with “modern equipment”, i.e. an apartment that has at least three of the following five features: (i) barrier-free access to a lift, (ii) built-in kitchen, (iii) “high quality” sanitary fit-out, (iv) “high quality” flooring in the majority of the living space and (v) low energy performance (less than 120 kWh/(m^2a). The bill does not contain a definition of what constitutes “high quality”.

For new lettings after June 18, 2019 and re-lettings after this bill has come into force, the rent must not exceed the lower of the applicable rent caps and the rent level as of June 18, 2019 (or earlier, as applicable). If the agreed monthly rent as of June 18, 2019 (or earlier) was below EUR 5.02 per m^2, the re-letting rent may be increased by EUR 1 per m^2 up to a maximum monthly rent of EUR 5.02 per m^2.

Once the act has been in effect for nine months, the tenants may request the public authorities to reduce the rent of all existing leases to the appropriate level if the rent is considered “extortionate”, i.e. if the rent exceeds the applicable rent cap level (subject to certain surcharges / discounts for the location of the premises) by more than 20% and it has not been approved by public authorities. The surcharges / discounts amount to +74 cents per m^2 (good location), -9 cents per m^2 (medium location) and –28 cents per m^2 (simple location).

(c) Modernization costs shall only be passed on to tenants if they relate to (i) measures required under statutory law, (ii) thermal insulation of certain building parts, (iii) measures for the use of renewable energies, (iv) window replacements to save energy, (v) replacement of the heating system, (vi) new installation of elevators or (vii) certain measures to remove barriers. Such costs can also only be passed on to tenants to the extent that the monthly rent is not increased by more than EUR 1 per m^2 and the applicable rent cap is not exceeded by more than EUR 1 per m^2. To cover the remaining modernization costs, landlords may apply for subsidies under additional subsidy programs of the state of Berlin. Any rent increase due to modernization measures is to be notified to the state-owned *Investitionsbank Berlin*.

Breaches of the material provisions of this bill are treated as an administrative offence and may be fined by up to EUR 500,000 in each individual case.

Many legal scholars consider the Berlin rent price cap unconstitutional (at least, in parts) for infringing the constitutional property guarantee, the freedom of contract and for procedural reasons. In particular, they raise concerns about whether the state of Berlin is competent to pass such local legislation (as certain provisions deviate from the German Civil Code (*BGB*) as federal law) and whether the planned retroactive effect is permissible. The opposition in the Berlin House of Representatives and a parliamentary faction on the federal level have already announced that they intend to have the Berlin rent cap reviewed by the Berlin's Regional Constitutional Court (*Verfassungsgerichtshof des Landes Berlin*) and the Federal Constitutional Court (*Bundesverfassungsgericht*). In light of the severe potential fines, landlords should nonetheless consider compliance with the provisions of the Berlin rent price cap until doubts on the constitutional permissibility have been finally clarified.

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5.2 Changes to the Transparency Register affecting Real Property Transactions

Certain aspects of the act implementing the 5th EU Anti-Money Laundering Directive (Directive (EU) 2018/843) which amended the German Anti-Money Laundering Act (*GwG*) are of particular interest to the property sector. We would, therefore, refer interested circles to the above summary in section 1.4.

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6. Compliance and Litigation

6.1 German Corporate Sanctions Act

German criminal law so far does not provide for corporate criminal liability. Corporations can only be fined under the law on administrative offenses.

In August 2019, the German Federal Ministry of Justice and Consumer Protection (*Bundesministerium der Justiz und für Verbraucherschutz*) circulated a legislative draft of the Corporate Sanctions Act (*Verbandssanktionengesetz*, the "**Draft Corporate Sanctions Act**") which would, if it became law, introduce a hybrid system. The main changes to the current legal situation would eliminate the prosecutorial discretion in initiating proceedings, tighten the sentencing framework and formally incentivize the implementation of compliance measures and internal investigations.

So far, German law grants the prosecution discretion on whether to prosecute a case against a corporation (whereas there is a legal obligation to prosecute individuals suspected of criminal wrongdoing). This has resulted not only in an inconsistent application of the law, in particular among different federal states, but also in a perceived advantageous treatment of corporations over individuals. The Draft Corporate Sanctions Act now intends to introduce mandatory prosecution of infringements by corporations, with an obligation to justify non-prosecution under the law. The law as currently proposed would also apply to criminal offenses committed abroad if the company is domiciled in Germany.

Under the current legal regime, corporations can be fined up to a maximum of EUR10 million (in addition to the disgorgement of profits from the legal violation), which is often deemed insufficient by the broader public. The Draft Corporate Sanctions Act plans to increase potential fines to a maximum of 10% of the annual—worldwide and group-wide—turnover, if the group has an average annual turnover of more than EUR100 million. Additionally, profits could still be disgorged.

The Draft Corporate Sanctions Act would also introduce two new sanctions: a type of deferred prosecution agreement with the possibility of imposing certain conditions (e.g. compensation for damages and monitorship), and a "corporate death penalty," namely the liquidation of the company to combat particularly persistent and serious criminal behavior.

The Draft Corporate Sanctions Act would also allow the prosecutor to either refrain from pursuing prosecution or to positively take into account in the determination of fines the existence of an adequate compliance system. If internal investigations are carried out in accordance with the requirements set out in the Draft Corporate Sanctions Act (including in particular: (i) substantial contributions to the authorities' investigation, (ii) formal division of labor between those conducting the internal investigation, on the one hand, and those acting as criminal defense counsel, on the other, (iii) full cooperation, including full disclosure of the investigation and its results to the prosecution, and (iv) adherence to fair trial standards, in particular the interviewee's right to remain silent in internal investigations), the maximum fine might be reduced by 50%, and the liquidation of the company or a public announcement might be precluded.

It is unclear under the current legal regime whether work product created in the context of an internal investigation is protected against prosecutorial seizure. The Draft Corporate Sanctions Act wants to introduce a clarification in this respect: only such documents will be protected against seizure that are part of the relationship of trust between the company as defendant and its defense counsel. Therefore, documents used or created in the preparation of the criminal defense would be protected. Documents from interviews in the context of an internal investigations, however, would only be protected in case they stem from the aforementioned relationship between client and defense counsel. Interestingly, and as mentioned above, the draft law requires that counsel conducting the internal investigation must be separate from defense counsel if the corporation wants to claim a cooperation bonus. How this can be achieved in practice, in particular in an international context where criminal defense counsel is often expected to conduct the internal investigation and where the protection of legal privilege may depend on this dual role, is unclear. In particular here, the draft does not seem sufficiently thought-through, and both the legal profession and the business community are voicing strong opposition.

Overall, it is doubtful at the moment that the current government coalition, in its struggle for survival, will continue to pursue the implementation of this legislative project as a priority. Therefore, it remains to be seen whether, when, and with what type of amendments the German Corporate Sanctions Act will be passed by the German Parliament.

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6.2 Amendments to the German Anti-Money Laundering Act: Further Compliance Obligations, including for the Non-Financial Sector

On January 1, 2020, the Act implementing the 5th EU Anti-Money Laundering Directive (Directive (EU) 2018/843) became effective. In addition to further extending the scope of businesses that are required to conduct anti-money laundering and anti-terrorist financing procedures in accordance with the German Anti-Money Laundering Act (*Geldwäschegesetz, GwG*), in particular in the area of virtual currencies, it introduced new obligations and stricter individual requirements for persons or entities subject to the GwG obligations ("**Obliged Persons**"). The new requirements must be taken into account especially in relation to customer onboarding and ongoing anti-money laundering and countering terrorist financing ("**AML/CTF**") compliance. The following overview provides a summary of some key changes, in particular, concerning the private non-financial sector, which apply in addition to the specific reporting obligations to the transparency register already described above under section 1.4.

- The customer due diligence obligations ("**KYC**") were further extended and also made more specific. In particular, Obliged Persons are now required to collect proof of registration in the transparency register or an excerpt of the documents accessible via the transparency register (e.g. shareholder lists) when entering into a new business relationship with a relevant entity. In addition, the documentation obligations with regard to the undertaken KYC measures have been further increased and clarified. Further important changes concern the enhanced due diligence measures required in the case of a higher risk of money laundering or terrorist financing, in particular with regard to the involvement of "high-risk countries".

- Obliged Persons must now also notify the registrar of the transparency register without undue delay of any discrepancies on beneficial ownership between entries in the transparency register and other information and findings available to them.
- Obliged Persons must register with the Financial Intelligence Unit (FIU), regardless of whether they intend to report a suspicious activity, as soon as the FIU's new information network starts its operations, but no later than January 1, 2024.
- In accordance with the findings of the First National Risk Assessment, the duties for the real estate sector were significantly extended and increased. Real estate agents are now also subject to the AML/CTF risk management requirements of the GwG and are required to conduct customer due diligence when they act as intermediaries in the letting of immovable property if the monthly rent amounts to EUR 10,000 or more. Furthermore, notaries are now explicitly required to check the conclusiveness of the identity of the beneficial owner before notarizing a real estate purchase transaction in accordance with section 1 of the German Federal Real Estate Transfer Tax Act (*Grunderwerbsteuergesetz*) and may even be required to refuse notarization, see also section 1.4 above on the transparency register.
- In an effort towards a more uniform EU-wide approach with regard to politically exposed persons ("**PEPs**"), EU member states must submit to the EU Commission a catalogue of specific functions and offices which under the relevant domestic law justify the qualification as PEP by January 10, 2020. The EU Commission will thereafter publish a consolidated catalogue, which will be binding for Obliged Persons when determining whether a contractual partner or beneficial owner qualifies as PEP with the consequence that enhanced customer due diligence applies.
- Furthermore, the new law brought some clarifications by changing or introducing definitions, including in particular a new self-contained definition for the term "financial company". For example, the legislator made clear that industrial holdings are not subject to the duties of the *GwG*: Any holding companies which exclusively hold participations in companies outside of the credit institution, financial institution or insurance sector do not qualify as financial companies under the *GwG*, unless they engage in business activities beyond the tasks associated with the management of their participations. That said, funds are not explicitly excluded from the definition of financial companies – and since their activities generally also include the acquisition and sale of participations, it is often questionable whether the exemption for holding companies applies.
- Another noteworthy amendment concerns the group-wide compliance obligations in section 9 of the *GwG*: the amended provision now distinguishes (more) clearly between obligations applicable to an Obliged Person that is the parent company of a group and the other members of the group.

The amendments to the *GwG* have further intensified the obligations not only for the classical financial sector but also the non-financial sector. Since the amendments entered into force on January 1, 2020, the relevant business circles are well advised to review whether their existing AML/CTF risk management system and KYC procedures need to be adjusted in order to comply with the new rules.

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6.3 First National Risk Assessment on the Money Laundering and Terrorist Financing Risk for Germany – Implications for the Company-Specific Risk Analyses

The first national risk assessment for the purposes of combatting money laundering and terrorist financing ("**NRA**") was finally published on the website of the German Federal Ministry of Finance (*Bundesministerium der Finanzen*) on October 21, 2019 (currently in German only). When preparing their company-specific risk analyses under the *GwG*, Obliged Persons must now take into consideration also the country-, product- and sector-specific risks identified in the NRA.

Germany as a financial center is considered a country with a medium-high risk (i.e. level 4 of a five-point scale from low to high) of being abused for money laundering and terrorist financing.

The NRA identifies, in particular, the following key risk areas: anonymity in transactions, the real estate sector, the banking sector (in particular, in the context of correspondent banking activities and international money laundering) and the money remittance business due to the high cash intensity and cross-border activities.

With regard to specific cross-border concerns, the NRA has identified eleven regions and states that involve a high risk of money laundering for Germany: Eastern Europe (particularly Russia), Turkey, China, Cyprus, Malta, the British Virgin Islands, the Cayman Islands, Bermuda, Guernsey, Jersey and the Isle of Man. Separately, a medium-high cross-border threat was identified for Lebanon, Panama, Latvia, Switzerland, Italy and Great Britain, and a further 17 countries were qualified as posing a medium, medium-low or low threat with regard to money laundering.

The results of the NRA (including the assessment of cross-border threats in its annex 4) need to be taken into consideration by Obliged Persons both of the financial and non-financial sector when preparing or updating their company-specific risk analyses in a way that allows a third party to assess how the findings of the NRA were accounted for. Obliged Persons (in particular, if supervised by the *BaFin* (*Bundesanstalt für Finanzdienstleistungsaufsicht*) or active in other non-financial key-risk sectors), if they have not already done so, should thus conduct a timely review, and document such a review, of whether the findings of the NRA require an immediate update to their risk assessment or whether they consider an adjustment in the context of their ongoing review.

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7. Antitrust and Merger Control

7.1 Antitrust and Merger Control Overview 2019

Germany's antitrust watchdog, the German Federal Cartel Office (*Bundeskartellamt*), has had another very active year. On the cartel enforcement side, the *Bundeskartellamt* concluded several cartel investigations and imposed fines totaling EUR 848 million against 23 companies or associations and 12 individuals from various industries including bicycle wholesale, building service providers, magazines, industrial batteries and steel. As in previous years, leniency applications continue to play an important role for the *Bundeskartellamt*'s antitrust enforcement activities with a total of 16 leniency applications received in 2019. With these applications and dawn raids at 32 companies, it can be expected that the agency will have significant ammunition for an active year in 2020 in terms of antitrust enforcement.

With respect to merger control, the *Bundeskartellamt* reviewed approximately 1,400 merger filings in 2019. 99% of these filings were concluded during the one-month phase 1 review. Only 14 merger filings (i.e. 1% of all merger filings) required an in-depth phase 2 examination. Of those, four mergers were prohibited and five filings were withdrawn – only one was approved in phase 2 without conditions, and four phase 2 proceedings are still pending.

In addition, the *Bundeskartellamt* has been very active in the area of consumer protection and concluded its sector inquiry into comparison websites. The agency has also issued a joint paper with the French competition authority regarding algorithms in the digital economy and their competitive effects. For 2020, it is expected that the *Bundeskartellamt* will conclude its sector inquiry regarding online user reviews as well as smart TVs and will continue to focus on the digital economy. Furthermore, the *Bundeskartellamt* has also announced that it is hoping to launch the Federal Competition Register for Public Procurement by the end of 2020 – an electronic register that will list companies that have been involved in serious economic offenses.

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7.2 Competition Law 4.0: Proposed Changes to German Competition Act

The German Federal Ministry for Economic Affairs and Energy (*Bundesministerium für Wirtschaft und Energie*) has compiled a draft bill for the tenth amendment to the German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen, GWB*) that aims at further developing the regulatory framework for digitalization and implementing European requirements set by Directive (EU) 2019/1 of December 11, 2018 by empowering the competition authorities of the member states to be more effective enforcers and to ensure the proper functioning of the internal market. While it is not yet clear when the draft bill will become effective, the most important changes are summarized below.

(Super) Market Dominance in the Digital Age

Various amendments are designed to help the Federal Cartel Office (*Bundeskartellamt*) deal with challenges created by restrictive practices in the field of digitalization and platform economy. One of the criteria to be taken into account when determining market dominance in the future would be "access to data relevant for competition". For the first time, companies that depend on data sets of market-dominating undertakings or platforms would have a legal claim to data access against such platforms. Access to data will also need to be granted in areas of relative market power. Giving up the reference to "small and medium-sized" enterprises as a precondition for an abuse of relative or superior market power takes into account the fact that data dependency may exist regardless of the size of the concerned enterprise.

Last but not least, the draft bill refers to a completely new category of "super dominant" market players to be controlled by the *Bundeskartellamt*, i.e. undertakings with "paramount significance across markets". Large digital groups may not have significant market shares in all affected markets, but may nevertheless be of significant influence on these markets due to their key position for competition and their conglomerate structures. Before initiating prohibitive actions against such "super dominant" market players, the *Bundeskartellamt* will have to issue an order declaring that it considers the undertaking to have a "paramount significance across markets", based on the exemplary criteria set out in the draft bill.

Rebuttable Presumptions

Following an earlier decision of the German Federal Supreme Court (*Bundesgerichtshof, BGH*), the draft bill suggests introducing a rebuttable presumption whereby it is presumed that direct suppliers and customers of a cartel are affected by the cartel in case of transactions during the duration of the cartel with companies participating in the cartel. The rebuttable presumption is intended to make it easier for claimants to prove that they are affected by the cartel. Another rebuttable presumption shall apply in favor of indirect customers in the event of a passing-on. However, there is still no presumption for the quantification of damages.

Another procedural simplification foreseen in the draft bill is a lessening of the prerequisites to prove an abuse of market dominance. It would suffice that market behavior resulted in an abuse of market dominance, irrespective of whether the market player utilized its dominance for abusive purposes.

Slight Increase of Merger Control Threshold

The draft bill provides for an increase of the second domestic turnover threshold from EUR 5 million to EUR 10 million. Concentrations would consequently only be subject to filing requirements in the future if, in the last business year preceding the concentration, the combined aggregate worldwide turnover of all the undertakings concerned was more than EUR 500 million, and the domestic turnover of, at least, one undertaking concerned was more than EUR 25 million and that of another undertaking concerned was more than EUR 10 million. This change aims at reducing the burden for small and medium-sized enterprises. The fact that transactions that provide for an overall consideration of more than EUR 400 million may trigger a filing requirement remains unchanged.

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7.3 “Undertakings” Concept Revisited – Parents Liable for their Children?

Following the *Skanska* ruling of the European Court of Justice (*ECJ*) earlier this year (case C-724/17 of March 14, 2019) , the first German court decisions (by the district courts (*Landgerichte*) of Munich and Mannheim) were issued in cases where litigants were trying to hold parent companies liable for bad behavior by their subsidiaries.

As a reminder: In *Skanska*, the ECJ ruled on the interpretation of Article 101 of the Treaty on the Functioning of the European Union (*TFEU*) in the context of civil damages regarding the application of the “undertakings” concept in cases where third parties claim civil damages from companies involved in cartel conduct. The “undertakings” concept, which the ECJ developed with regard to the determination of administrative fines for violations of Article 101 TFEU, establishes so-called parental liability. This means that parent entities may be held liable for antitrust violations committed by their subsidiaries, as long as the companies concerned are considered a “single economic unit” because the parent has “decisive influence” over the offending company and is exercising that influence. The *Skanska* case extends parental liability to civil damages cases.

The decisions by the two German courts in Mannheim and Munich denied a subsidiary’s liability for its parent company, or for another subsidiary, respectively.

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8. Data Protection: GDPR Fining Concept Raises the Stakes

While some companies are still busy implementing the requirements of the General Data Protection Regulation (the “**GDPR**”), the German Conference of Federal and State Data Protection Authorities has increased the pressure in October 2019 by publishing guidelines for the determination of fines in privacy violation proceedings against companies (the "**Fining Concept**"). Even though the Fining Concept may seem technical at first glance, it has far-reaching consequences for the fine amounts, which have already manifested in practice.

The Fining Concept applies to the imposition of fines by German Data Protection Authorities within the scope of the GDPR. Since the focus for determining fines is on the global annual turnover of a company in the preceding business year, it is to be expected that fines will increase significantly. For further details, please see our client update from October 30, 2019 on this subject.

In the past few months, in particular after the Fining Concept was published, several German Data Protection Authorities already issued a number of higher fines. Most notably, in November 2019 the Berlin Data Protection Authority imposed a fine against a German real estate company in the amount of EUR 14.5 million (approx. USD 16.2 million) for non-compliance with general data processing principles. The company used an archive system for the storage of personal data from tenants, which did not include a function for the deletion of personal data. In December 2019, another fine in the amount of EUR 9.5 million (approx. USD 10.6 million) was imposed by the Federal Commissioner for Data Protection and Freedom of Information against a major German telecommunications service provider for insufficient technical and organizational measures to prevent unauthorized persons from being able to obtain customer information.

Many German data protection authorities have announced further investigations into possible GDPR violations and recent fines indicate that the trend towards higher fine levels will continue. This development leaves no doubt that the German Data Protection Authorities are willing to use the sharp teeth that data protection enforcement has received under the GDPR – and leave behind the rather symbolic fine ranges that were predominant in the pre-GDPR era. This is particularly true in light of the foreseeable temptation to use the concept of "undertakings" as developed under EU antitrust laws, which may include parental liability for GDPR violations of subsidiaries in the context of administrative fines as well as civil damages. For further details on the concept of "undertakings" in light of recent antitrust case law, please see above under Section 7.3.

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9. IP & Technology

On April 26, 2019, the German Trade Secret Act (the "**Act**") came into effect, implementing the EU Trade Secrets Directive (2016/943/EU) on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure. The Act aims at consolidating what has hitherto been a potpourri of civil and criminal law provisions for the protection of trade secrets and secret know-how in German legislation.

Besides an enhanced protection of trade secrets in litigation matters, one of the most important changes to the pre-existing rules in Germany is the creation of a new and EU-wide definition of trade secrets. Trade secrets are now defined as information that (i) is secret (not publicly known or easily available), (ii) has a commercial value because it is secret, (iii) is subject to reasonable steps to keep it secret, and (iv) there is a legitimate interest to keeping it secret. This definition therefore requires the holder of a trade secret to take reasonable measures to keep a trade secret confidential in order to benefit from its protection. To prove compliance with this requirement when challenged, trade secret holders will further have to document and track their measures of protection. This requirement goes beyond the previous standard pursuant to which a manifest interest in keeping an information secret would have been sufficient. There is no clear guidance yet on what is to be understood as "reasonable measures" in this respect. A good indication may be the comprehensive case law developed by U.S. courts when interpreting the requirement of “reasonable efforts” to maintain the secrecy of a trade secret under the U.S. Uniform Trade Secrets Act. Besides a requirement to advise recipients that the information is a confidential trade secret not to be disclosed (e.g. through non-disclosure agreements), U.S. courts consider the efforts of limiting access to a “need-to-know” scope (e.g. through password protection).

Another point that is of particular importance for corporate trade secret holders is that companies may be indirectly liable for negligent breaches of third-party trade secrets by their employees. Enhanced liability risks may therefore result when hiring employees who were formerly employed by a competitor and had access to the competitor’s trade secrets.

Reverse engineering of lawfully acquired products is now explicitly considered a lawful means of acquiring information, except when otherwise contractually agreed. Previously, reverse engineering was only lawful if it did not require considerable expense. To avoid disclosing trade secrets that form part of a product or object by surrendering prototypes or samples, contracts should provide for provisions to limit the acquisition of the trade secret.

In a nutshell, companies would be well advised to review their internal policies and procedures to determine whether there are reasonable and sufficiently trackable legal, technical and organizational measures in place for the protection of trade secrets, to observe and assess critically what know-how is brought into an organization by lateral hires, and to amend contracts for the surrender of prototypes and samples as appropriate.

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Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding the issues discussed in this update. The two German offices of Gibson Dunn in Munich and Frankfurt bring together lawyers with extensive knowledge of corporate, financing and restructuring, tax, labor, real estate, antitrust, intellectual property law and extensive compliance / white collar crime and litigation experience. The German offices are comprised of seasoned lawyers with a breadth of experience who have assisted clients in various industries and in jurisdictions around the world. Our German lawyers work closely with the firm's practice groups in other jurisdictions to provide cutting-edge legal advice and guidance in the most complex transactions and legal matters. For further information, please contact the Gibson Dunn lawyer with whom you work or any of the following members of the German offices:

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