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2018 YEAR-END GERMAN LAW UPDATE

To Our Clients and Friends:

Looking back at the past year's cacophony of voices in a world trying to negotiate a new balance of powers, it appeared that Germany was disturbingly silent, on both the global and European stage.

Instead of helping shape the new global agenda that is in the making, German politics focused on sorting out the vacuum created by a Federal election result which left no clear winner other than a newly formed right wing nationalist populist party mostly comprised of so called *Wutbürger* (the new prong for "citizens in anger") that managed to attract 12.6 % of the vote to become the third strongest party in the German Federal Parliament.

The relaunching of the Grand-Coalition in March after months of agonizing coalition talks was followed by a bumpy start leading into another session of federal state elections in Bavaria and Hesse that created more distraction. When normal business was finally resumed in November, a year had passed by with few meaningful initiatives formed or significant business accomplished. In short, while the world was spinning, Germany allowed itself a year's time-out from international affairs.

The result is reflected in this year's update, where the most meaningful legal developments were either triggered by European initiatives, such as the General Data Protection Regulation ("GDPR") (see below section 4.1) or the New Transparency Rules for Listed German Companies (see below section 1.2), or as a result of landmark rulings of German or international higher and supreme courts (see below Corporate M&A sections 1.1 and 1.4; Tax – sections 2.1 and 2.2 and Labor and Employment – section 4.2). In fairness, shortly before the winter break at least a few other legal statutes have been rushed through parliament that are also covered by this update.

Of the changes that are likely to have the most profound impact on the corporate world, as well as on the individual lives of the currently more than 500 million inhabitants of the EU-28, the GDPR, in our view, walks away with the first prize. The GDPR has created a unified legal system with bold concepts and strong mechanisms to protect individual rights to one's personal data, combined with hefty fines in case of the violation of its rules.

As such, the GDPR stands out as a glowing example for the EU's aspiration to protect the civic rights of its citizens, but also has the potential to create a major exposure for EU-based companies processing and handling data globally, as well as for non EU-based companies doing business in Europe. On a more strategic scale, the GDPR also creates a challenge for Europe in the global race for supremacy in a AI-driven world fueled by unrestricted access to data - the gold of the digital age.

The German government could not resist infection with the virus called protectionism, this time around coming in the form of greater scrutiny imposed on foreign direct investments into German companies being considered as "strategic" or "sensitive" (see below section 1.3 - Germany Tightens Rules on Foreign Takeovers Even Further).

Protecting sensitive industries from "unwanted" foreign investors, at first glance, sounds like a laudable cause. However, for a country like Germany that derives most of its wealth and success from exporting its ideas, products and services, a more liberal approach to foreign investments would seem to be more appropriate, and it remains to be seen how the new rules will be enforced in practice going forward.

The remarkable success of the German economy over the last twenty five years had its foundation in the abandoning of protectionism, the creation of an almost global market place for German products, and an increasing global adoption of the rule of law. All these building blocks of the recent German economic success have been under severe attack in the last year. This is definitely not the time for Germany to let another year go by idly.

We use this opportunity to thank you for 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.

Without our daily interaction with your real-world questions and tasks, our expertise would be missing the focus and color to draw an accurate picture of the multi-facetted world we are living in. In this respect, we thank you for making us better lawyers - every day.

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1.1 Further Development regarding D&O Liability of the Supervisory Board in a German Stock Corporation

In its famous "ARAG/Garmenbeck"-decision in 1997, the German Federal Supreme Court (*Bundesgerichtshof - BGH*) first established the obligation of the supervisory board of a German Stock Corporation (*Aktiengesellschaft*) to pursue the company's D&O liability claims in the name of the company against its own management board after having examined the existence and enforceability of such claims. Given the very limited discretion the court has granted to the supervisory board not to bring such a claim and the supervisory board's own liability arising from inactivity, the number of claims brought by companies against their (former) management board members has risen significantly since this decision.

In its recent decision dated September 18, 2018, the *BGH* ruled on the related follow-up question about when the statute of limitations should start to run with respect to compensation claims brought by the company against a supervisory board member who has failed to pursue the company's D&O liability claims against the board of management within the statutory limitation period.

The *BGH* clarified that the statute of limitation applicable to the company's compensation claims against the inactive supervisory board member (namely ten years in case of a publicly listed company, otherwise five years) should not begin to run until the company's compensation claims against the management board member have become time-barred themselves. With that decision, the court adopts the view that in cases of inactivity, the period of limitations should not start to run until the last chance for the filing of an underlying claim has passed.

In addition, the *BGH* in its decision confirmed the supervisory board's obligation to also pursue the company's claims against the board of management in cases where the management board member's misconduct is linked to the supervisory board's own misconduct (e.g. through a violation of supervisory duties). Even in cases where the pursuit of claims against the board of management would force the supervisory board to disclose its own misconduct, such "self-incrimination" does not release the supervisory board from its duty to pursue the claims given the preponderance of the company's interests in an effective supervisory board, the court reasoned.

In practice, the recent decision will result in a significant extension of the D&O liability of supervisory board members. Against that backdrop, supervisory board members are well advised to examine the existence of the company's compensation claims against the board of management in a timely fashion and to pursue the filing of such claims, if any, as soon as possible. If the board of management's misconduct is linked to parallel misconduct of the supervisory board itself, the relevant supervisory board member – if not exceptionally released from pursuing such claim and depending on the relevant facts and circumstances – often finds her- or himself in a conflict of interest arising from such self-incrimination in connection with the pursuit of the claims. In such a situation, the supervisory board member might consider resigning from office in order to avoid a conflict of interest arising from such self-incrimination in connection with the pursuit of the claims.

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1.2 Upcoming New Transparency Rules for Listed German Companies as well as Institutional Investors, Asset Managers and Proxy Advisors

In mid-October 2018, the German Federal Ministry of Justice finally presented the long-awaited draft for an act implementing the revised European Shareholders' Rights Directive (Directive (EU) 2017/828). The Directive aims to encourage long-term shareholder engagement by facilitating the communication between shareholders and companies, in particular across borders, and will need to be implemented into German law by June 10, 2019 at the latest. The new rules primarily target listed German companies and provide some major changes with respect to the "say on pay" provisions, as well as additional approval and disclosure requirements for related party transactions, the transmission of information between a stock corporation and its shareholders and additional transparency and reporting requirements for institutional investors, asset managers and proxy advisors.

"Say on pay" on directors' remuneration: remuneration policy and remuneration report

Under the current law, the 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. The law only provides for the possibility of an additional shareholder vote on the management board members' remuneration if such vote is put on the agenda by the management and supervisory boards in their sole discretion. Even then, such vote has no legal effects whatsoever ("voluntary say on pay"). In the future, shareholders of German listed companies will have two options. *First*, the supervisory board will have to prepare a detailed remuneration policy 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 ("mandatory say on pay"). That said, the result of the vote on the policy will continue to remain only advisory. However, if the supervisory board adopts a remuneration policy that has been rejected by the shareholders, it will then be required to submit a reviewed (not necessarily revised) remuneration policy to the shareholders at the next shareholders' meeting. With respect to the remuneration of supervisory board members, the new rules require a shareholders vote at least once every four years. *Second*, at the annual shareholders' meeting the shareholders will vote ex post on the remuneration report (which is also reviewed by the statutory auditor) which contains the remuneration granted to the present and former members of the management board and the supervisory board in the past financial year. Again, the shareholders' vote, however, will only be advisory. Both the remuneration report including the audit report, as well as the remuneration policy will have to be made public on the company's website for at least ten years.

Related party transactions

German stock corporation law already provides for various safeguard mechanisms to protect minority shareholders in cases of 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, in the case of listed companies, these mechanisms will be supplemented by a detailed set of approval and transparency requirements for transactions between the company and related parties. Material transactions exceeding certain thresholds will require prior supervisory board approval. A rejection by the supervisory board can be overcome by shareholder vote.

Furthermore, a listed company must publicly disclose any such material related party transaction, without undue delay over media providing for a Europe-wide distribution.

Identification of shareholders and facilitation of the exercise of shareholders' rights

Listed companies 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 company 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. In addition, companies will be required to confirm the votes cast at the request of the shareholders thus enabling them to be certain that their votes have been effectively cast, including in particular across borders.

Transparency requirements for institutional investors, asset managers and proxy advisors

German domestic institutional investors and asset managers with Germany as their home member state (as defined in the applicable sector-specific EU law) will be required (i) to disclose their engagement policy, including how they monitor, influence and communicate with the investee companies, exercise shareholders' rights and manage actual and potential conflicts of interests, and (ii) to report annually on the implementation of their engagement policy and disclose how they have cast their votes in the general meetings of material investee companies. Institutional investors will further have to disclose (iii) consistency between the key elements of their investment strategy with the profile and duration of their liabilities and how they contribute to the medium to long-term performance of their assets, and, (iv) if asset managers are involved, to disclose the main aspects of their arrangement with the asset manager. The new disclosure and reporting requirements, however, only apply on a "comply or explain" basis. Thus, investors and asset managers may choose not to make the above disclosures, provided they give an explanation as to why this is the case.

Proxy advisors will have to publicly disclose on an annual basis (i) whether and how they have applied their code of conduct based again on the "comply or explain" principle, and (ii) 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.

The present legislative draft is still under discussion and it is to be expected that there will still be some changes with respect to details before the act becomes effective in mid-2019. Due to transitional provisions, the new rules on "say on pay" will have no effect for the majority of listed companies in this year's meeting season. Whether the new rules will actually promote a long-term engagement of shareholders and have the desired effect on the directors' remuneration of listed companies will have to be seen. 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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1.3 Germany Tightens Rules on Foreign Takeovers Even Further

After the German government had imposed stricter rules on foreign direct investment in 2017 (see 2017 Year-End German Law Update under 1.5), it has now even further tightened its rules with respect to takeovers of German companies by foreign investors. The latest amendment of the rules under the German Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung*, "*AWV*") enacted in 2018 was triggered, among other things, by the German government's first-ever veto in August 2018 regarding the proposed acquisition of Leifeld Metal Spinning, a German manufacturer of metal forming machines used in the automotive, aerospace and nuclear industries, by Yantai Taihai Corporation, a privately-owned industry group from China, on the grounds of national security. Ultimately, Yantai withdrew its bid shortly after the German government had signaled that it would block the takeover.

On December 29, 2018, the latest amendment of the Foreign Trade and Payments Ordinance came into force. The new rules provide for greater scrutiny of foreign direct investments by lowering the threshold for review of takeovers of German companies by foreign investors from the acquisition of 25% of the voting rights down to 10% in circumstances where the target operates a critical infrastructure or in sensitive security areas (defense and IT security industry). In addition, the amendment also expands the scope of the Foreign Trade and Payments Ordinance to also apply to certain media companies that contribute to shaping the public opinion by way of broadcasting, teleservices or printed materials and stand out due to their special relevance and broad impact. While the lowering of the review threshold as such will lead to an expansion of the existing reporting requirements, the broader scope is also aimed at preventing German mass media from being manipulated with disinformation by foreign investors or governments. There are no specific guidelines published by the German government as it wants the relevant parties to contact, and enter into a dialog with, the authorities about these matters. While the German government used to be rather liberal when it came to foreign investments in the past, the recent veto in the case of Leifeld as well as the new rules show that in certain circumstances, it will become more cumbersome for dealmakers to get a deal done.

Finally, it is likely that the rules on foreign investment control will be tightened even further going forward in light of the contemplated EU legislative framework for screening foreign direct investment on a pan-European level.

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1.4 US Landmark Decision on MAE Clauses - Consequences for German M&A Deals

Fresenius wrote legal history in the US with potential consequences also for German M&A deals in which "material adverse effect" (MAE) clauses are used.

In December 2018, for the first time ever, the Supreme Court of Delaware allowed a purchaser to invoke the occurrence of an MAE and to terminate the affected merger agreement. The agreement included an MAE clause, which allocated certain business risks concerning the target (Akorn) for the time period between signing and closing to Akorn. Against the resistance of Akorn, Fresenius terminated the merger agreement based on the alleged MAE, arguing that the target's EBITDA declined by 86%.

The decision includes a very detailed analysis of an MAE clause by the Delaware courts and reaffirms that under Delaware law there is a very high bar to establishing an MAE. Such bar is based both on quantitative and qualitative parameters. The effects of any material adverse event need to be substantial as well as lasting.

In most German deals, the parties agree to arbitrate. For this reason, there have been no German court rulings published on MAE clauses so far. Hence, all parties to an M&A deal face uncertainty about how German courts or arbitration tribunals would define "materiality" in the context of an MAE clause.

In potential M&A litigation, sellers may use this ruling to support the argument that the bar for the exercise of the MAE right is in fact very high in line with the Delaware standard. It remains to be seen whether German judges will adopt the Delaware decision to interpret MAE clauses in German deals. Purchasers, who seek more certainty, may consider defining materiality in the MAE clause more concretely (e.g., by reference to the estimated impact of the event on the EBITDA of the company or any other financial parameter).

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1.5 Equivalence of Swiss Notarizations?

The question whether the notarization of various German corporate matters may only be validly performed by German notaries or whether some or all of these measures may also be notarized validly by Swiss notaries has long since been the topic of legal debate. Since the last major reform of the German Limited Liability Companies Act (*Gesetz betreffend Gesellschaften mit beschränkter Haftung - GmbHG*) in 2008 the number of Swiss notarizations of German corporate measures has significantly decreased. A number of the newly introduced changes and provisions seemed to cast doubt on the equivalence and capacity of Swiss notaries to validly perform the duties of a German notary public who are not legally bound by the mandatory, non-negotiable German fee regime on notarial fees. As a consequence and a matter of prudence, German companies mostly stopped using Swiss notaries despite the potential for freely negotiated fee arrangements and the resulting significant costs savings in particular in high value matters.

However, since 2008 there has been an increasing number of test cases that reach the higher German courts in which the permissibility of a Swiss notarization is the decisive issue. While the German Federal

Supreme Court (*Bundesgerichtshof* - *BGH*) still has not had the opportunity to decide this question, in 2018 two such cases were decided by the *Kammergericht* (Higher District Court) in Berlin. In those cases, the court held that both the incorporation of a German limited liability company in the Swiss Canton of Berne (KG Berlin, 22 W 25/16 - January 24, 2018 = ZIP 2018, 323) and the notarization of a merger between two German GmbHs before a notary in the Swiss Canton of Basle (KG Berlin, 22 W 2/18 – July 26, 2018 = ZIP 2018, 1878) were valid notarizations under German law, because Swiss notaries were deemed to be generally equivalent to the qualifications and professional standards of German-based notaries.

The reasons given in these decisions are reminiscent of the case law that existed prior to the 2008 corporate law reform and can be interpreted as indicative of a certain tendency by the courts to look favorably on Swiss notarizations as an alternative to German-based notarizations. Having said that and absent a determinative decision by the *BGH*, using German-based notaries remains the cautious default approach for German companies to take. This is definitely the case in any context where financing banks are involved (e.g. either where share pledges as loan security are concerned or in an acquisition financing context of *GmbH* share sales and transfers). On the other hand, in regions where such court precedents exist, the use of Swiss notaries for straightforward intercompany share transfers, mergers or conversions might be considered as an alternative on a case by case basis.

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1.6 Re-Enactment of the DCGK: Focus on Relevance, Function, Management Board's Remuneration and Independence of Supervisory Board Members

Sixteen years after it has first been enacted, the German Corporate Governance Code (*Deutscher Corporate Governance Kodex*, *DCGK*), which contains standards for good and responsible governance for German listed companies, is facing a major makeover. In November 2018, the competent German government commission published a first draft for a radically revised DCGK. While vast parts of the proposed changes are merely editorial and technical in nature, the draft contains a number of new recommendations, in particular with respect to the topics of management remuneration and independence of supervisory board members. With respect to the latter, the draft now provides a catalogue of criteria that shall act as guidance for the supervisory board as to when a shareholder representative shall no longer be regarded as independent. Furthermore, the draft also provides for more detailed specifications aiming for an increased transparency of the supervisory board's work, including the recommendation to individually disclose the members' attendance of meetings, and further tightens the recommendations regarding the maximum number of simultaneous mandates for supervisory board members. Moreover, in addition to the previous concept of "comply or explain", the draft DCGK introduces a new "apply and explain" concept, recommending that listed companies also explain how they apply certain fundamental principles set forth in the DCGK as a new third category in addition to the previous two categories of recommendations and suggestions.

The draft DCGK is currently under consultation and the interested public is invited to comment upon the proposed amendments until the end of January 2019. Since some of the proposed amendments provide for a rather fundamentally new approach to the current regime and would introduce additional administrative burdens, it remains to be seen whether all of the proposed amendments will actually come into force. According to the current plan, following a final consultancy of the Government Commission, the revised version of the DCGK shall be submitted for publication in April 2019 and would take effect shortly thereafter.

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2. Tax

On November 23, 2018, the German Federal Council (*Bundesrat*) approved the German Tax Reform Act 2018 (*Jahressteuergesetz* 2018, the "Act"), which had passed the German Federal Parliament (*Bundestag*) on November 8, 2018. Highlights of the Act are (i) the exemption of restructuring gains from German income tax, (ii) the partial abolition of and a restructuring exemption from the loss forfeiture rules in share transactions and (iii) the extension of the scope of taxation for non-German real estate investors investing in Germany.

2.1 Exemption of Restructuring Gains

The Act puts an end to a long period of uncertainty - which has significantly impaired restructuring efforts - with respect to the tax implications resulting from debt waivers in restructuring scenarios (please see in this regard our 2017 Year-End German Law Update under 3.2). Under German tax law, the waiver of worthless creditor claims creates a balance sheet profit for the debtor in the amount of the nominal value of the payable. Such balance sheet profit is taxable and would - without any tax privileges for such profit – often outweigh the restructuring effect of the waiver. The Act now reinstates the tax exemption of debt waivers with retroactive effect for debt waivers after February 8, 2017; upon application debt waivers prior to February 8, 2017 can also be covered. Prior to this legislative change, a tax exemption of restructuring gains was based on a restructuring decree of the Federal Ministry of Finance, which has been applied by the tax authorities since 2003. In 2016, the German Federal Fiscal Court (*Bundesfinanzgerichtshof*) held that the restructuring decree by the Federal Ministry of Finance violates constitutional law since a tax exemption must be legislated by statute and cannot be based on an administrative decree. Legislation was then on hold pending confirmation from the EU Commission that a legislative tax exemption does not constitute illegal state aid under EU law. The EU Commission finally gave such confirmation by way of a comfort letter in August 2018.

The Act is largely based on the conditions imposed by a restructuring decree issued by the Federal Ministry of Finance on the tax exemption of a restructuring gain. Under the Act, gains at the level of the debtor resulting from a full or partial debt relief are exempt from German income tax if the relief is granted to recapitalize and restructure an ailing business. The tax exemption only applies if at the time of the debt waiver (i) the business is in need of restructuring and (ii) capable of being restructured, (iii) the waiver results in a going-concern of the restructured business and (iv) the creditor waives the debt with the intention to restructure the business. The rules apply to German corporate income and trade tax and benefit individuals, partnerships and corporations alike. Any gains from the relief must first be reduced by all existing loss-offsetting potentials before the taxpayer can benefit from tax exemptions on restructuring measures.

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2.2 Partial Abolition of Loss Forfeiture Rules/Restructuring Exception

Under the current Loss Forfeiture Rules, losses of a German corporation will be forfeited on a pro rata basis if within a period of five years more than 25% but not more than 50% of the shares in the German loss-making corporation are transferred (directly or indirectly) to a new shareholder or group of shareholders with aligned interests. If more than 50% are transferred, losses will be forfeited in total. There are exceptions to this rule for certain intragroup restructurings, built-in gains and business continuations, especially in the venture capital industry.

On March 29, 2017, the German Federal Constitutional Court (*Bundesverfassungsgericht – BVerfG*) ruled that the pro rata forfeiture of losses (a share transfer of more than 25% but not more than 50%) is incompatible with the constitution. The court has asked the German legislator to amend the Loss Forfeiture Rules retroactively for the period from January 1, 2008 until December 31, 2015 to bring them in line with the constitution. Somewhat surprisingly, the legislator has now decided to fully cancel the pro rata forfeiture of losses with retroactive effect and with no reference to a specific tax period.

Currently pending before the German Federal Constitutional Court is the question whether the full forfeiture of losses is constitutional. A decision by the Federal Constitutional Court is expected for early 2019, which may then result in another legislative amendment of the Loss Forfeiture Rules.

The Act has also reinstated a restructuring exception from the forfeiture rules - if the share transfer occurs in order to restructure the business of an ailing corporation. Similar to the exemption of restructuring gains, this legislation was on hold until the ECJ's decision (*European Court of Justice*) on June 28, 2018 that the restructuring exception does not violate EU law. Existing losses will not cease to exist following a share transfer if the restructuring measures are appropriate to avoid or eliminate the illiquidity or the over-indebtedness of the corporation and to maintain its basic operational structure. The restructuring exception applies to share transfers after December 31, 2007.

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2.3 Investments in German Real Estate by Non-German Investors

So far, capital gains from the disposal of shares in a non-German corporation holding German real estate were not subject to German tax. In a typical structure, in which German real estate is held via a Luxembourg or Dutch entity, a value appreciation in the asset could be realized by a share deal of the holding company without triggering German income taxes.

Under the Act, the sale of shares in a non-German corporation is now taxable if, at some point within a period of one year prior to the sale of shares, 50 percent of the book value of the assets of the company consisted of German real estate and the seller held at least 1 percent of the shares within the last five years prior to the sale. The Act is now in line with many double tax treaties concluded by Germany, which allow Germany to tax capital gains in these cases. The new law applies for share transfers after

December 31, 2018. Capital gains are only subject to German tax to the extent the value has been increased after December 31, 2018.

Until 2018, a change in the value of assets and liabilities, which are economically connected to German real estate, was not subject to German tax. Therefore, for example, profits from a waiver of debt that was used to finance German real estate was not taxable in Germany whereas the interest paid on the debt was deductible for German tax purposes. That law has now changed and allows Germany to tax such profit from a debt waiver if the loan was used to finance German real estate. However, only the change in value that occurred after December 31, 2018 is taxable.

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3. Financing and Restructuring – Test for Liquidity Status Tightened

On December 19, 2017, the German Federal Supreme Court (*Bundesgerichtshof – BGH*) handed down an important ruling which clarifies the debt and payable items that should be taken into account when determining the "liquidity" status of companies. According to the Court, the liquidity test now requires managing directors and (executive) board members to determine whether a liquidity gap exceeding 10% can be overcome by incoming liquidity within a period of three weeks taking into account all payables which will become due in those three weeks.

Prior to the ruling, managing directors had often argued successfully that only those payables that were due at the time when the test is applied needed be taken into account while expected incoming payments within a three week term could be considered. This mismatch in favor of the managing directors has now been rectified by the Court to the disadvantage of the managing directors. If, for example, on June 1 the company liquidity status shows due payables amounting to EUR 100 and plausible incoming receivables in the three weeks thereafter amounting to EUR 101, no illiquidity existed under the old test. Under the new test confirmed by the Court, payables of EUR 50 becoming due in the three week period now also have to be taken into account and the company would be considered illiquid.

For companies and their managing directors following a cautious approach, the implications of this ruling are minor. Going forward, however, even those willing to take higher risks will need to follow the court determined principles. Otherwise, delayed insolvency filings could ensue. This not only involves a managing directors and executive board members' personal liability for payments made on behalf of the company while illiquid but also potential criminal liability for a delayed insolvency filing. Managing directors are thus well advised to properly undertake and also document the required test in order to avoid liability issues.

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4. Labor and Employment

4.1 GDPR Has Tightened Workplace Privacy Rules

The EU General Data Protection Regulation ("GDPR") started to apply on May 25, 2018. It has introduced a number of stricter rules for EU countries with regard to data protection which also apply to employee personal data and employment relationships. In addition to higher sanctions, the regulation provides for extensive information, notification, deletion, and documentation obligations. While many of these data privacy rules had already been part of the previous German workplace privacy regime under the German Federal Data Protection Act (*Bundesdatenschutzgesetz - BDSG*), the latter has also been amended and provides for specific rules applicable to employee data protection in Germany (e.g. in the context of internal investigations or with respect to employee co-determination). However, the most salient novelty is the enormous increase in potential sanctions under the GDPR. Fines for GDPR violations can reach up to the higher of EUR 20 million or 4% of the group's worldwide turnover. Against this backdrop, employers are well-advised to handle employee personnel data particularly careful. This is also particularly noteworthy as the employer is under an obligation to prove compliance with the GDPR – which may result in a reversal of the burden of proof e.g. in employment-related litigation matters involving alleged GDPR violations.

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4.2 Job Adverts with Third Gender

Following a landmark decision by the German Federal Constitutional Court in 2017, employers are gradually inserting a third gender into their job advertisements. The Federal Constitutional Court (*Bundesverfassungsgericht – BVerfG*) decided on October 10, 2017 that citizens who do not identify as either male or female were to be registered as "diverse" in the birth register (1 BvR 2019/16). As a consequence of this court decision, many employers in Germany have broadened gender notations in job advertisements from previously "m/f" to "m/f/d". While there is no compelling legal obligation to do so, employers tend to signal their open-mindedness by this step, but also mitigate the potential risk of liability for a discrimination claim. Currently, such liability risk does not appear alarming due to the relative rarity of persons identifying as neither male nor female and the lack of a statutory stipulation for such adverts. However, employers might be well-advised to follow this trend, particularly after Parliament confirmed the existence of a third gender option in birth registers in mid-December.

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4.3 Can Disclosure Obligation Reduce Gender Pay-Gap?

In an attempt to weed out gender pay gaps, the German lawmaker has introduced the so-called Compensation Transparency Act in 2017. It obliges employers, inter alia, to disclose the median compensation of comparable colleagues of the opposite gender with comparable jobs within the company. The purpose is to give a potential claimant (usually a female employee) an impression of how much her comparable male colleagues earn in order for her to consider further steps, e.g. a claim for more money. However, the new law is widely perceived as pointless. First, the law itself and its processes are unduly complex. Second, even after making use of the law, the respective employee would still have to sue the company separately in order to achieve an increase in her compensation, bearing the burden of proof that the opposite-gender employee with higher compensation is comparable to her. Against this background, the law has hardly been used in practice and will likely have only minimal impact.

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4.4 Employers to Contribute 15% to Deferred Compensation Schemes

In order to promote company pension schemes, employers are now obliged to financially support deferred compensation arrangements. So far, employer contributions to any company pension scheme had been voluntary. In the case of deferred compensation schemes, companies save money as a result of less social security charges. The flipside of this saving was a financial detriment to the employee's statutory pension, as the latter depends on the salary actually paid to the employee (which is reduced as a result of the deferred compensation). To compensate the employee for this gap, the employer is now obliged to contribute up to 15% of the respective deferred compensation. The actual impact of this new rule should be limited, as many employers already actively support deferred compensation schemes. As such, the new obligatory contribution can be set off against existing employer contributions to the same pension scheme.

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5. Real Estate – Notarization Requirement for Amendments to Real Estate Purchase Agreements

Purchase agreements concerning German real estate require notarization in order to be effective. This notarization requirement relates not only to the purchase agreement as such but to all closely related (side) agreements. The transfer of title to the purchaser additionally requires an agreement *in rem* between the seller and the purchaser on the transfer (*conveyance*) and the subsequent registration of the transfer in the land register. To avoid additional notarial fees, parties usually include the conveyance in the notarial real estate purchase agreement.

Amendment agreements to real estate purchase agreements are quite common (*e.g.*, the parties subsequently agree on a purchase price adjustment or the purchaser has special requests in a real estate development scenario). Various Higher District Courts (*Oberlandesgerichte*), together with the prevailing opinion in literature, have held in the past that any amendments to real estate purchase agreements also require notarization unless such an amendment is designed to remove unforeseeable difficulties with the implementation of the agreement without significantly changing the parties' mutual obligations. Any amendment agreement that does not meet the notarization requirement may render the entire purchase agreement (and not only the amendment agreement) null and void.

With its decision on September 14, 2018, the German Federal Supreme Court (*Bundesgerichtshof – BGH*) added another exception to the notarization requirement and ruled that notarization of an amendment agreement is not required once the conveyance has become binding and the amendment does not change the existing real estate transfer obligations or create new ones. A conveyance becomes binding once it has been validly notarized.

Before this new decision of the *BGH*, amendments to real estate purchase agreements were often notarized for the sake of precaution because it was difficult to determine whether the conditions for an exemption from the notarization requirement had been met. This new decision of the *BGH* gives the parties clear guidance as to when amendments to real estate purchase agreements require notarization. It should, however, be borne in mind that notarization is still required if the amendment provides for new transfer obligations concerning the real property or the conveyance has not become effective yet (*e.g.*, because third party approval is still outstanding).

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6. Compliance

6.1 Government Plans to Introduce Corporate Criminal Liability and Internal Investigations Act

Plans of the Federal Government to introduce a new statute concerning corporate criminal liability and internal investigations are taking shape. Although a draft bill had already been announced for the end of 2018, pressure to respond to recent corporate scandals seems to be rising.

With regard to the role and protection of work product generated during internal investigations, the highly disputed decisions of the Federal Constitutional Court (*Bundesverfassungsgericht – BVerfG*) in June 2018 (BVerfG, 2 BvR 1405/17, 2 BvR 1780/17 – June 27, 2018) (see 2017 Year-End German Law Update under 7.3) call for clearer statutory rules concerning the search of law firm premises and the seizure of documents collected in the course of an internal investigation.

In its dismissal of complaints brought by Volkswagen and its lawyers from Jones Day, the Federal Constitutional Court made remarkable *obiter dicta* statements in which it emphasized the following: (1) the legal privilege enjoyed for the communication between the individual defendant (*Beschuldigter*) and its criminal defense counsel is limited to their communication only; (2) being considered a foreign corporate body, the court denied Jones Day standing in the proceedings, because the German constitution only grants rights to corporate bodies domiciled in Germany; and (3) a search of the offices of a law firm does not affect individual constitutional rights of the lawyers practicing in that office, because the office does not belong to the lawyers' personal sphere, but only to their law firm.

The decision and the additional exposure caused by it by making attorney work product created in the course of an internal investigation accessible was a major blow to German corporations' efforts to foster internal investigations as a means to efficiently and effectively investigate serious compliance concerns.

Because it does not appear likely that an entirely new statute concerning corporate criminal liability will materialize in the near future, the legal press expects the Federal Ministry of Justice to consider an approach in which the statutes dealing with questions around internal investigations and the protection of work product created in the course thereof will be clarified separately.

In the meantime, the following measures are recommended to maximize the legal privilege for defense counsel (*Verteidigerprivileg*): (1) Establish clear instructions to an individual criminal defense lawyer setting forth the scope and purpose of the defense; (2) mark work product and communications that have been created in the course of the defense clearly as confidential correspondence with defense counsel (*"Vertrauliche Verteidigerkorrespondenz"*); and (3) clearly separate such correspondence from other correspondence with the same client in matters that are not clearly attributable to the criminal defense mandate. While none of these measures will guarantee that state prosecutors and courts will abstain from a search and seizure of such material, at least there are good and valid arguments to defend the legal privilege in any appeals process. However, with the guidance provided to courts by the recent constitutional decision, until new statutory provisions provide for clearer guidance, companies can expect this to become an up-hill battle.

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6.2 Update on the European Public Prosecutor's Office and Proposed Cross-Border Electronic Evidence Rules

Recently the European Union has started tightening its cooperation in the field of criminal procedure, which was previously viewed as a matter of national law under the sovereignty of the 28 EU member states. Two recent developments stand out that illustrate that remarkable new trend: (1) The introduction of the European Public Prosecutor's Office ("EPPO") that was given jurisdiction to conduct EU-wide investigations for certain matters independent of the prosecution of these matters under the national laws of the member states, and (2) the proposed EU-wide framework for cross-border access to electronically stored data ("e-evidence") which has recently been introduced to the European Parliament.

As reported previously (see 2017 Year-End German Law Update under 7.4), the European Prosecutor's Office's task is to independently investigate and prosecute severe crimes against the EU's financial interests such as fraud against the EU budget or crimes related to EU subsidies. Corporations receiving funds from the EU may therefore be the first to be scrutinized by this new EU body. In 2018 two additional EU member states, the Netherlands and Malta, decided to join this initiative, extending the number of participating member states to 22. The EPPO will presumably begin its work by the end of 2020, because the start date may not be earlier than three years after the regulation's entry into force.

As a further measure to leverage multi-jurisdictional enforcement activities, in April 2018 the European Commission proposed a directive and a regulation that will significantly facilitate expedited cross-border access to e-evidence such as texts, emails or messaging apps by enforcement agencies and judicial authorities. The proposed framework would allow national enforcement authorities in accordance with their domestic procedure to request e-evidence directly from a service provider located in the jurisdiction of another EU member state. That other state's authorities would not have the right to object to or to review the decision to search and seize the e-evidence sought by the national enforcement authority of the requesting EU member state. Companies refusing delivery risk a fine of up to 2% of their worldwide annual turnover. In addition, providers from a third country which operate in the EU are obliged to appoint a legal representative in the EU.

The proposal has reached a majority vote in the Council of the EU and will now be negotiated in the European Parliament. Further controversial discussions between the European Parliament and the Commission took place on December 10, 2018. The Council of the EU aims at reaching an agreement between the three institutions by the end of term of the European Parliament in May 2019.

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7. Antitrust and Merger Control

7.1 Antitrust and Merger Control Overview 2018

In 2018, Germany celebrated the 60th anniversary of both the German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen -GWB*) as well as the German federal cartel office (*Bundeskartellamt*) which were both established in 1958 and have since played a leading role in competition enforcement worldwide.

The celebrations notwithstanding, the German antitrust watchdog has had a very active year in substantially all of its areas of competence. On the enforcement side, the *Bundeskartellamt* concluded a number of important cartel investigations. According to its annual review, the *Bundeskartellamt* carried out dawn raids at 51 companies and imposed fines totaling EUR 376 million against 22 companies or associations and 20 individuals from various industries including the steel, potato manufacturing, newspapers and rolled asphalt industries. Leniency applications remained an important source for the *Bundeskartellamt*'s antitrust enforcement activities with a total of 21 leniency applications received in 2018 filling the pipeline for the next few months and years.

On the merger control side, the *Bundeskartellamt* reviewed approximately 1,300 merger cases in 2018 – only 1% of which (i.e. 13 merger filings) required an in-depth phase 2 review. No mergers were prohibited but in one case only conditional clearance was granted and three filings were withdrawn in phase 2.

In addition, the *Bundeskartellamt* had its first full year of additional responsibilities in the area of consumer protection, concluded a sector inquiry into internet comparison portals, and started a sector inquiry into the online marketing business as well as a joint project with the French competition authority CNIL regarding algorithms in the digital economy and their competitive effects.

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7.2 Cartel Damages

Over the past few years, antitrust damages law has advanced in Germany and the European Union. One major legislative development was the EU Directive on actions for damages for infringements of competition law, which was implemented in Germany as part of the 9th amendment to the German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen -GWB*). In addition, there has also been some noteworthy case law concerning antitrust damages.

To begin with, the German Federal Supreme Court (*Bundesgerichtshof, BGH*) strengthened the position of plaintiffs suing for antitrust damages in its decision Grauzementkartell II in 2018. The decision brought to an end an ongoing dispute between several Higher District Courts and District Courts, which had disagreed over whether a recently added provision of the GWB that suspends the statute of limitations in cases where antitrust authorities initiate investigations would also apply to claims that arose before the amendment entered into force (July 1, 2015). The Federal Supreme Court affirmed the suspension of the statute of limitations, basing its ruling on a well-established principle of German law regarding the intertemporal application of statutes of limitation. The decision concerns numerous antitrust damage suits, including several pending cases concerning trucks, rails tracks, and sugar cartels.

Furthermore, recent case law shows that European domestic courts interpret arbitration agreements very broadly and also enforce them in cases involving antitrust damages. In 2017, the England and Wales High Court and the District Court Dortmund (*Landgericht Dortmund*) were presented with two antitrust disputes where the parties had agreed on an arbitration clause. Both courts denied jurisdiction because the antitrust damage claims were also covered by the arbitration agreements. They argued that the parties could have asserted claims for contractual damages instead, which would have been covered by the arbitration agreement. In the courts' view, it would be unreasonable, however, if the choice between asserting a contractual or an antitrust claim would give the parties the opportunity to influence the jurisdiction of a court. As a consequence, the use of arbitration clauses (in particular if inconsistently used by suppliers or purchasers) may add significant complexity to antitrust damages litigation going forward. Thus, companies are well advised to examine their international supply agreements to determine whether included arbitration agreements will also apply to disputes about antitrust damages.

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7.3 Appeals against Fines Risky?

In German antitrust proceedings, there is increasing pressure for enterprises to settle. Earlier this year, *Radeberger*, a producer of lager beer, withdrew its appeal against a significant fine of EUR 338 million, which the *Bundeskartellamt* had imposed on the company for its alleged participation in the so-called "beer cartel". With this dramatic step, *Radeberger* paid heed to a worrisome development in German competition law. Repeatedly, enterprises have seen their cartel fines increased by staggering amounts on appeal (despite such appeals sometimes succeeding on some substantive legal issues). The reason for these "appeals for the worse" – as seen in the liquefied gas cartel (increase of fine from EUR 180 million to EUR 244 million), the sweets cartel (average increase of approx. 50%) and the wallpaper cartel (average increase of approx. 35%) – is the different approach taken by the *Bundeskartellamt* and the courts to calculating fines. As courts are not bound by the administrative practice of the *Bundeskartellamt*, many practitioners are calling for the legislator to step in and address the issue.

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7.4 Luxury Products on Amazon – The Coty Case

In July 2018, the Frankfurt Higher District Court (*Oberlandesgericht Frankfurt*) delivered its judgement in the case *Coty / Parfümerie Akzente*, ruling that Coty, a luxury perfume producer, did not violate competition rules by imposing an obligation on its selected distributors to not sell on third-party platforms such as Amazon. The judgment followed an earlier decision of the Court of Justice of the European Union (*ECJ*) of December 2017, by which the ECJ had replied to the Frankfurt court's referral. The ECJ had held that a vertical distribution agreement (such as the one in place between Coty and its distributor Parfümerie Akzente) did not as such violate Art. 101 of the Treaty on the Functioning of the European Union (TFEU) as long as the so-called *Metro* criteria were fulfilled. These criteria stipulate that distributors must be chosen on the basis of objective and qualitative criteria that are applied in a non-discriminatory fashion; that the characteristics of the product necessitate the use of a selective distribution network in order to preserve their quality; and, finally, that the criteria laid down do not go beyond what is necessary. Regarding the platform ban in question, the ECJ held that it was not disproportionate.

Based on the ECJ's interpretation of the law, the Frankfurt Higher District Court confirmed that the character of certain products may indeed necessitate a selective distribution system in order to preserve their prestigious reputation, which allowed consumers to distinguish them from similar goods, and that gaps in a selective distribution system (e.g. when products are sold by non-selected distributors) did not per se make the distribution system discriminatory. The Higher District Court also concluded that the platform ban in question was proportional. However, interestingly, it did not do so based on its own reasoning but based on the fact that the ECJ's detailed analysis did not leave any scope for its own interpretation and, hence, precluded the Higher District Court from applying its own reasoning. Pointing to the European Commission's E-Commerce Sector Inquiry, according to which sales platforms play a more important role in Germany than in other EU Member States, the Higher District Court, in fact, voiced doubts whether Coty's sales ban could not have been imposed in a less interfering manner.

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8. Litigation

8.1 The New German "Class Action"

On November 1, 2018, a long anticipated amendment to the German Code of Civil Procedure (*Zivilprozessordnung*, *ZPO*) entered into force, introducing a new procedural remedy for consumers to enforce their rights in German courts: a collective action for declaratory relief.

Although sometimes referred to as the new German "class action," this new German action reveals distinct differences to the U.S.-American remedy. Foremost, the right to bring the collective action is limited to consumer protection organizations or other "qualified institutions" (*qualifizierte Einrichtung*) who can only represent "consumers" within the meaning of the German Code of Civil Procedure. In addition, affected consumers are not automatically included in the action as part of a class but must actively opt-in by registering their claims in a "claim index" (*Klageregister*). Furthermore, the collective action for declaratory relief does not grant any monetary relief to the plaintiffs which means that each consumer still has to enforce its claim in an individual suit to receive compensation from the defendant. Despite these differences, the essential and comparable element of the new legal remedy is its binding effect. Any other court which has to decide an individual dispute between the defendant and a registered consumer that is based on the same facts as the collective action is bound by the declaratory decision of the initial court. At the same time, any settlement reached by the parties has a binding effect on all registered consumers who did not decide to specifically opt-out.

As a result, companies must be aware of the increased litigation risks arising from the introduction of the new collective action for declaratory relief. Even though its reach is not as extensive as the American class action, consumer protection organizations have already filed two proceedings against companies from the automotive and financial industry since the amendment has entered into force in November 2018, and will most likely continue to make comprehensive use of the new remedy in the future.

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8.2 The New 2018 DIS Arbitration Rules

On March 1, 2018, the new 2018 DIS Arbitration Rules of the German Arbitration Institute (*DIS*) entered into force. The update aims to make Germany more attractive as a place for arbitration by adjusting the rules to international standards, promoting efficiency and thereby ensuring higher quality for arbitration proceedings.

The majority of the updated provisions and rules are designed to accelerate the proceedings and thereby make arbitration more attractive and cost-effective for the parties. There are several new rules on time limitations and measures to enhance procedural efficiency, i.e. the possibility of expedited proceedings or the introduction of case management conferences. Furthermore, the rules now also allow for consolidation of several arbitrations and cover multi-party and multi-contract arbitration.

Another major change is the introduction of the DIS Arbitration Council which, similar to the Arbitration Council of the ICC (International Chamber of Commerce), may decide upon challenges of an arbitrator and review arbitral awards for formal defects.

This amendment shows that the influence of DIS on their arbitration proceedings has grown significantly. All in all, the modernized 2018 DIS Arbitration Rules resolve the deficiencies of their predecessor and strengthen the position of the German Institution of Arbitration among competing arbitration institutions.

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9. IP & Technology - Draft Bill of German Trade Secret Act

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 has already been in effect since July 5, 2016. Even though it was supposed to be implemented into national law by June 9, 2018 to harmonize the protection of trade secrets in the EU, the German legislator has so far only prepared and published a draft of the proposed German Trade Secret Act. Arguably, the most important change in the draft bill to the existing rules on trade secrets in Germany will be a new and EU-wide definition of trade secrets. This proposed definition requires the holder of a trade secret to take reasonable measures to keep a trade secret confidential in order to benefit from its protection – e.g. by implementing technical, contractual and organizational measures that ensure secrecy. This requirement goes beyond the current standard pursuant to which a manifest interest in keeping an information secret may be sufficient.

Furthermore, the draft bill provides for additional protection of trade secrets in litigation matters. Last but not least, the draft bill also provides for increased protection of whistleblowers by reducing the barriers for the disclosure of trade secrets in the public interest and to the media.

As a consequence, companies would be advised to review their internal procedures and policies regarding the protection of trade secrets at this stage, and may want to adapt their existing whistleblowing and compliance-management-systems as appropriate.

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10. International Trade, Sanctions and Export Controls - The Conflict between Complying with the Re-Imposed U.S. Iran Sanctions and the EU Blocking Statute

On May 8, 2018, President Donald Trump announced his decision to withdraw from the Joint Comprehensive Plan of Action (JCPOA) and re-impose U.S. nuclear-related sanctions. Under the JCPOA, *General License H* had permitted U.S.-owned or -controlled non-U.S. entities to engage in business with Iran. But with the end of the wind-down periods provided for in President Trump's decision on November 5, 2018, such non-U.S. entities are now no longer broadly permitted to provide goods, services, or financing to Iranian counterparties, not even under agreements executed before the U.S. withdrawal from the JCPOA.

In response to the May 8, 2018 decision, the EU amended the EU Blocking Statute on August 6, 2018. The effect of the amended EU Blocking Statute is to prohibit compliance by so-called EU operators with the re-imposed U.S. sanctions on Iran. Comparable and more generally drafted anti-blocking statutes had already existed in the EU and several of its member states which prohibited EU domiciled companies to commit to compliance with foreign boycott regulations.

These competing obligations under EU and U.S. laws are a concern for U.S. companies that own or seek to acquire German companies that have a history of engagement with Iran – as well as for the German company itself and its management and the employees.

But what does the EU prohibition against compliance with the re-imposed U.S. sanctions on Iran mean in practice?

Most importantly, it must be noted that the EU Blocking Statute does not oblige EU operators to start or continue Iran related business. If, for example, an EU operator voluntarily decides, e.g. due to lack of profitability, to cease business operations in Iran and not to demonstrate compliance with the U.S. sanctions, the EU Blocking Statute does not apply. Obviously, such voluntary decision must be properly documented.

Procedural aspects also remain challenging for companies:

In the event a Germany subsidiary of a U.S. company were to decide to start or continue business with Iran, it would usually be required to reach out to the U.S. authorities to request a specific license for a particular transaction with Iran. Before doing so, however, EU operators must first contact the EU Commission directly (not the EU member state authorities) to request authorization to apply for such a U.S. special license.

Likewise, if a Germany subsidiary were to decide not to start or to cease business with Iran for the sole reason of being compliant with the re-imposed U.S. Iran sanctions, it would have to apply for an exception from the EU Blocking Statute and would have to provide sufficient evidence that non-compliance would cause serious damage to at least one protected interest.

The hurdles for an exception are high and difficult to predict. The EU Commission will e.g. consider, "(…) *whether the applicant would face significant economic losses, which could for example threaten its viability or pose a serious risk of bankruptcy*, or *the security of supply of strategic goods or services within or to the Union or a Member State and the impact of any shortage or disruption therein."*

As such, any company caught up in this conflict of interests between the re-imposed U.S. sanctions and the EU Blocking Statute should be aware of a heightened risk of litigation. Third parties, such as Iranian counterparties, might successfully sue for breach of contract with the support of the EU Blocking Regulation in cases of non-performance of contracts as a result of the re-imposed U.S. nuclear sanctions.

Finally, EU operators are required to inform the EU Commission within 30 days from the date on which information is obtained that the economic and/or financial interests of the EU operator are affected, directly or indirectly, by the re-imposed U.S. Iran sanctions. If the EU operator is a legal person, this obligation is incumbent on its directors, managers and other persons with management responsibilities of such legal person.

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