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Doing Business in Germany Bulletin

May 2008

Dear Reader,

We are delighted to present to you the latest edition of our "Doing Business in Germany Bulletin".

This Bulletin contains reports from some of the firm's Practice Groups. Important recent legal developments which we believe may be of interest to you have been reviewed and commented by the respective Practice Group. This edition of the Bulletin focuses on various matters which are covered by our Corporate & Tax practice group, while other topics relate to the practice groups Labour as well as IP, Competition and Communications.

We hope that you will find the information in this Bulletin helpful. Please do not hesitate to contact us if you have any questions, remarks or other feed-back regarding the topics addressed in this newsletter or any other matters.

Yours sincerely,

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Corporate & Tax

May 2008

New German accounting standards in preparation

The German government has presented its first draft of the Accounting Law Reform Act (the "**Act**"), which is said to be the most far-reaching reform in German accounting law since more than twenty years. Providing a true option to apply international accounting standards without adopting their inconveniences is the leitmotiv of the Act, which pursues two major goals:

-► The Act aims to cater to the requirements of the international business community which regularly applies International Financial Reporting Standards (IFRS) by adap ting the requirements regarding the contents of the balance sheet under the German Commercial Code (HGB) to international standards

-► The Act simplifies preparation of the balance sheet. This applies in particular to many small and medium-sized companies by increasing the legal threshold values which trigger various accounting and publication obligations, thus relieving many smaller businesses from such obligations.

Numerous medium-sized companies became de facto subject to reporting obligations according to IFRS in the past due to the fact that only IFRS balance sheets were deemed to be sufficiently precise to reflect the true value of an enterprise. Knowledge of the true value, however, is crucial for obtaining private equity or debt capital. The new law is designed to increase the significance of accounting under the HGB. In addition, many small and medium sized companies are relieved from considerable costs for the preparation of accounts under IFRS.

Based on the Act, companies are considered to be "small" and "medium" within the meaning of the Act if they comply with at least two of the following three criteria:

Small Companies:	
Balance sheet total	Not exceeding € 4,840,000.00 (currently: € 4,015,000.00).
Turnover	Not exceeding €9,860,000.00 (currently: € 8,030,000.00).
Annual average numer of employees:	50 (currently: 50)
Medium-sized compnanies:	
Balance sheet total	Not exceeding € 19,250,000.00 (currently: € 16,060,000.00).
Turnover	Not exceeding € 38,500,000.00 (currently: €32,120,000.00).
Annual average number of employees:	250 (currently: 250).

The Act also provides for some important changes in the valuation of specific balance sheet items:

-► Intellectual property rights created and owned by a company (patents, know-how, etc.) must henceforth be activated in the company's balance sheet;

-► Financial instruments acquired for trading purposes will be valued at fair mar ket value on the balance sheet date;

-► In the valuation of accruals, future developments with regard to price tenden cies (such as development of wages and prices) will be taken into account to a greater extent.

Increased transparency in relation to "special purpose vehicles" ("SPV's") is another aim of the reform. According to the draft bill, SPV's must be included in the group annual accounts

if the SPV is managed by the parent company. Companies are obliged to disclose the purpose and the financial impact of any business activity which is not declared in the company's balance sheet if such information is required for the assessment of the company's financial situation.
The new law will be applicable to accounting years starting in 2009. However, the increased thresholds (see above) could already apply to annual reports in regard to accounting years starting in 2008.

Acquisitions of German Companies subject to Government Screening

The German government is planning to amend the Foreign Trade and Payment Act (so that an acquisition of a company by a foreign investor can be reviewed, restricted and also prohibited by the German Federal Ministry of Economics and Technology ("Ministry"). The changes are designed to prevent foreign state-owned funds or other foreign financial investors such as, e.g., hedge funds, from acquiring influence over German companies. By ensuring that the buyer is not perceived to be a threat to public policy, political influence by investors from certain countries would be prevented. It is likely that the new law will come into effect in the first half of 2008.

The new legislation would authorize the Ministry to prohibit an acquisition by a foreign investor in the case of an acquisition of at least 25% of the voting rights of the target company in case of concerns regarding public policy or security. The new law will apply not only to a direct acquisition of a German company by a foreign investor, but also allow the Ministry to intervene in case of an indirect acquisition by a foreign investor, i.e., where an investor acquires a German company which in turn is owned by a company that is regarded as a danger to public order or security. The term foreign investor does not only include foreign companies but also applies to German companies in which a foreign investor holds more than 25% of the voting rights. The Foreign Trade and Payment Act (Außenwirtschaftsgesetz) at present already includes a similar provision according to which certain acquisitions can be banned by the Ministry. However, this regulation only relates to the acquisition of manufacturers of weapons and other defense equipment and certain developers of cryptography systems. The draft bill extends the Ministry's authorization to prohibit an acquisition to any kind of business.

According to the draft bill, the Ministry has the right to review the transaction. The Ministry must decide whether or not it wishes to review the acquisition within three months as of the date of signing of the purchase agreement or as of the date a takeover bid is announced. During this three-month period, the purchase agreement is suspended. If the Ministry does not prohibit the acquisition within one month after the receipt of the required documents, the purchase agreement becomes effective. However, in the current draft bill there is no notification requirement, i.e. the parties to the acquisition are not obligated to notify the Ministry of the transaction.

If the Ministry decides to review the transaction, the acquirer is obligated to provide the Ministry with complete documents relating to the acquisition. However, the bill does not state which documents are to be provided. Upon receipt of the complete documentation, the Ministry is authorized to prohibit or restrict the acquisition if it jeopardizes Germany's public order or security; otherwise, the acquisition becomes valid.

According to the European Court of Justice, only significant threats constitute a danger to the public order or security. However, even if one assumes that this is a very substantial threshold, the term is still very broad and vague. Therefore, the scope of the term "public order or security" could cause considerable uncertainties that might lead to significant disruptions of ongoing acquisitions.

As the European Commission has voiced serious concerns, it is likely that European investors will be excluded from the new regulations. Furthermore, the current version of the draft bill is likely to be modified substantially, e.g., by the introduction of a notification requirement for all transactions. Irrespective of what modifications are ultimately adopted, the net effect of the proposed legislation is to deter foreign investors from investing in Germany. However, it remains to be seen whether Germany's legislators will heed the warning calls which they are hearing from many quarters.

Intellectual Property,Competition and Communication

May 2008

New Copyright Law in Germany

On January 1, 2008 the Act on Copyright Law in the Information Society (the "**Act**") came into effect. The Act is designed to adjust German copyright law to ongoing technological developments.

According to the Act, the copying of unprotected contents for private purposes continues to be legal. On the other hand, the circumvention of copy-protection measures now constitutes not only a violation of copyright law, but also a criminal offense.

Furthermore, the Act makes it clear that file-sharing in peer-to-peer networks (e.g., YouTube, Gnutella, etc.) is illegal if the files which are being downloaded are subject to copyright. Thus, downloading music files or commercial movies from peer-to-peer networks as well as the provision of such files on a downloadable platform is a violation of copyright law.

The Act also contains certain modifications with regard to the copyright levy which is payable on any hardware used for the copying of protected contents as well as data storage devices sold in Germany. Due to numerous legal disputes concerning this levy, the Act implements a regulation whereupon the German collecting societies and the equipment manufacturers' association have to negotiate the details regarding this levy. The benchmark for the levy is the extent to which such equipment is customarily used for copying purposes.

Intellectual Property,Competition and Communication

May 2008

New EU rules to crack down on misleading advertising and aggressive sales practices

New EU rules to crack down on misleading advertising and aggressive selling practices - including a ban on fake "free" offers and a ban on "pester power" advertising (direct exhortation) to children on the Internet – were set forth in the EU Directive 2005/29/EC on Unfair Commercial Practices (the "Directive"). As Germany has missed the deadline for transforming the Directive into national law which expired on 12 December 2007, German courts are obliged to consider the Directive in the interpretation of German national law.

The Directive contains an extensive black list of schemes which are banned, targeting in particular a "dirty dozen" of the some of the most abusive practices, from bait advertising to pyramid schemes, advertorials and false curative health claims which are used vis-à-vis consumers. The Directive substantially reinforces existing EU standards on misleading advertising and sets new EU standards against aggressive commercial practices - covering harassment, coercion, and undue influence. The Directive aims to boost consumer and business confidence in the Single Market so people can fully benefit from cross border shopping.

The new rules include four key elements:

-► a far reaching catch all clause defining practices which are deemed unfair and therefore prohibited,
-► a list of categories of unfair commercial practices,
-► provisions that aim at preventing exploitation of vulnerable consumers, and
-► an extensive black list of practices that are banned outrightly if used vis-à-vis consumers.

The following business practices are, inter alia, named on the black list:

-► Bait advertising whereby consumers are lured into buying products from a company by promoting a product at a very low price without having a reaso nable stock of the product available for delivery.
-► Fake free offers which create the impression of a free offer by describing a pro duct as "gratis" (or similar) if the consumer has to pay anything other than the unavoidable cost of responding to the advertisement and the cost of collecti on or delivery of the product.
-► False claims about a product's healing capacity and the use of editorial content

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in the media to promote a product where the promotion was in fact paid for by the manufacturer or dealer without disclosure of this fact.

- Pyramid schemes where the compensation is derived primarily from the intro duction of third parties into the scheme rather than from the sale of the pro duct.
- Creating the false impression that the consumer has won a prize when there is no prize or taking action to claiming the prize is subject to the consumer pay ing money or incurring costs.
- Presenting the consumer's legal rights as a distinctive feature offered by the manufacturer or dealer.
- False statements that a product is available only for a very limited time to deprive consumers of sufficient opportunity to make an informed choice and the undertaking to provide after-sales service to consumers.
- Undertaking to provide after-sales services to consumers with whom the tra der has communicated prior to the transaction in a language which is not the official language of the Member State where the trader is located, making such service available only in another language without clearly disclosing this to the consumer prior to the transaction;
- Demanding of immediate or deferred payment for or the return or safekeeping of products which were supplied without solicitation by the consumer.
- "Europe-wide guarantees" giving the false impression that after-sales services for a product are available in EU Member States other than the one where the product was sold.

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New German Gambling Regulations

The new state treaty on gambling (the "Treaty") came into effect at the beginning of this year. The 16 federal states which have the authority to pass regulations in regard to gambling in Germany were challenged to modify the existing regime due to a decision of the Federal Constitutional Court in which the court had declared the then existing gambling regime as unconstitutional.

The new regime complies with the requirements set by the Federal Constitutional Court. The Treaty will be in force until 1st January 2012. It applies to

- the arranging of,
- the operating of, and
- the providing for

any form of gambling. Horse racing and gambling machines as well as games of skill and fun games are not covered by the new regulations.

The key targets of the new regulations are the prevention of gambling addiction, the governance and supervision of gambling offerings as well as the protection of minors and young people.

State monopoly upheld

Under the terms of the treaty any arranging of and providing for gambling by private operators requires a license. The licence shall not be granted where the arranging of and the providing for gambling would be contrary to one of the key targets of the Treaty (see above). Thus, the state monopoly on gambling is upheld.

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Internet advertising ban

The Treaty also provides for a complete ban on internet gambling. Any violation may be punished by fines up to € 500,000. However, in 2008 private operators may still offer gambling on the internet, provided that such gambling activities comply with the requirements of the new Treaty.

Restrictions on other types of advertising

Advertising is limited to the provision of information on the opportunity to gamble and must not be directed at minors or other vulnerable groups of the population. Advertising for public gambling on the internet, on TV or by means of telecommunications as well as any advertising for gambling which has not been expressly permitted is prohibited. In addition, advertising must not be deceptive and should not invite, offer incentives to or encourage gambling.

Blocking of financial transactions and IT services

German authorities are authorized to take appropriate measures in order to enforce the Treaty. In particular, they may prohibit financial institutions from processing payments relating to illegal gambling. Internet providers may be required to block access to unauthorised gambling sites. Authorities may impose considerable fines of up to € 500,000 for any violation. However, fines in respect of the ban on internet gambling which were dropped at the last minute. It remains to be seen how the authorities will proceed with the enforcement of the Treaty.

Legal uncertainty

Serious concerns voiced by the EU as to whether the new regulations comply with EU law (in particular in respect to internet gambling) were rejected by the Heads of States during the drafting of the Treaty. It is expected that the European Commission will initiate formal infringement proceedings against Germany. There are already various actions against the Treaty pending before German courts, which were partly referred to the European Court of Justice. Thus, the new regulations introduced legal uncertainty within the domain of gambling law in Germany. Until a final court decision in the matter is rendered, all operators of gambling activities, financial institutions, advertising companies and internet providers not complying with the new regime may be subject to enforcement measures of the authorities under the Treaty.

Public Commercial Law

May 2008

New German Renewable-Energies Act

In 2005 the German government decided to amend the regime regarding electricity generated from renewable energies, the so-called Renewable Energies Act. After the 2004 European Renewable Energy Council (EREC) had launched the idea of a binding target of 20% of the energy used within the EU to originate from renewable energy sources by 2020, the European Commission included this idea into its Renewable Energy Roadmap in January 2007. European Heads of State and of Governments agreed to this binding target. In August 2007 the German government presented a first draft of a revised Renewable-Energies-Act (the "Act 2009"), which will replace the current Renewable-Energies-Act 2004 ("Act 2004").

Current Principles

The Act 2004 aims to increase the portion of renewable energies in the total electricity supply to 25% or 30 % by the year 2020. The principle of the Act 2009 is that a certain fixed fee is paid to those plant operators who produce electricity from certain renewable energy sources such as hydro power, land fill gas, biomass, wind and solar energy ("Renewable Energies"). The local grid operator is required to provide priority access to its grid to plants which produce energy from renewable energies only. Furthermore, the grid operators are obliged to remunerate the plant operator on the basis of fixed statutory rates ("Tariffs") which decrease annually as incentive to operate the plants more efficiently. The additional costs, which are caused by the difference between the Tariffs and the actual market price for electricity are divided equally among all power producers and will be passed on to the consumer.

New Incentives

The Act 2009 maintains the general principles of the Act 2004. However, the Act 2009 aims to increase the incentive to install power plants that produce Renewable Energy from particularly favorable sources by considering their particular developments and efficiency on the basis of past experience. The Act 2009 also significantly increases the Tariffs on offshore wind energy, hydroelectricity and geothermal energy beginning in 2009. Most significantly, Germany, with the most aggressive renewable energy targets in the world, has increased those targets yet again. The Ministry of Environment announced that the targets for 2020 had increased to 27% of overall power generation from the previous 20% and had added a target of 45% by 2030. Previously, Germany had set a renewable target of 50% of total energy consumption by 2050. Germany's Renewable Energy Sources Act is reviewed every three years.

Labour Law

May 2008

Compliance in Employment Law – An essential tool for every company

As the number of rules and regulations which carry not only serious financial and/or criminal sanctions, but which may also inflict serious reputational damage on a company in the event of an infringement is ever increasing, compliance is becoming an issue even for smaller companies in Germany these days.

In employment law, there are many traps for the unwary: according to the new Act on Equal Treatment any kind of discrimination of employees is to be avoided, furthermore, violations of the German Working Time Act, the German Data Protection Act, the Law on Temporary Employment, the failure of the employer to pay over social security contributions in due time or any discriminatory as well as preferential treatment of members of the works council may result in substantial sanctions and loss of image for the employer. A compliance-relevant misconduct can not only occur at the executive level, but also among regular employees, in particular those who work in the sales or purchasing departments or key account managers for markets which are susceptible for corruption.

Possible Scope of compliance regulations

Employment law-related compliance rules generally include mandatory "do's and don'ts" which have to be observed by the employees. Effective tools for the implementation of such rules may be in-house controlling systems and information gathering mechanisms such as, e.g., the establishment of a "whistle blowing hotline" whereby employees can report suspected offences to an independent (external) compliance manager/ombudsman. However, it should be noted that so-called "ethical guidelines" which regulate not only work-related but also private behaviour of the employees are valid only to a very limited extent. Thus, for example an outright prohibition of any sexual relationship with trainees would not be upheld by a German court since ethical guidelines are subject to limits imposed by German Constitutional law including the right of personal self-determination.

Labour Law

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Options for implementing Compliance regulations in Germany

Compliance regulations concerning labor law may be implemented either by the employer's power of direction, by mutual agreement between employer and the employee, or by collective bargaining agreements (e.g. employer/works council agreements). Each of these options has its pros and cons:

To the extent that only the work behaviour of the employee is concerned, the employer can set up compliance standards simply by issuing directives which offers the advantage that any such regulations are easily adjustable to continuously changing requirements. As long as the employer only intends to clarify existing legal obligations (e.g., criminal, tax, competition or accounting laws), issuing a directive is the appropriate option. But the employer's power of direction are subject to certain statutory limitations. Thus, the employer's right to give directives may be limited by the German co-determination law if a works council exists in the company. If compliance regulations not only affect the work behaviour, but also govern how the employees behave among each other, the works council has a right of co-determination. Therefore, the introduction of a "whistle blowing hotline" is not subject to co-determination as long as (i) the offences reported are serious, (ii) the employees are required to inform the employer due to their contractual duty of good faith, and (iii) no further obligation or compulsory proceeding on whistle-blowing is imposed on the employee.

If the contents of compliance regulations exceed the employer's power of direction, companies should enter into contractual agreements with their employees. However, the employees are not obliged to enter into an agreement with the employer. Consequently, a consistent standard with regard to compliance regulations among the employees is difficult to achieve by way of individual agreements. Furthermore, this approach can turn out to be effort- and time-consuming, since every modification of compliance regulations requires an amendment of the agreement between the parties. If the employee refuses to agree to a modification of the original agreement, the employer can only enforce a modification by notice of termination causing a change of contract. In order to be valid, the notice of termination causing a change of contract needs to be socially justified according to the German Employment Protection Act if the company has more than ten employees.

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In companies where a works council is established, the employer also has the possibility to conclude a collective bargaining agreement with the works council. An employer/works council agreement has many advantages compared to a contractual agreement. First of all, many subject matters of compliance regulations are subject to co-determination by the works council. Secondly, a collective bargaining agreement applies uniformly to all employees of the company. Furthermore, modifications can easily enforced by a subsequent - even disadvantagous - employer/works council agreement. Finally, the terms of a collective bargaining agreement are not subject to the same restrictions on standard terms and conditions as individual contractual agreements.

Sanctions

Any violations of compliance regulations can only be enforced if there are adequate sanctions. Therefore, compliance regulations must contain corresponding agreements or at least warning indications which make it clear to the employee that violations will not be tolerated and will result in damages and disciplinary measures, including the termination of the employment contract. The issuance of a warning letter prior to termination of the employment will, however, only be unnecessary in the event of serious violations of compliance regulations.

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