

German News Flash



GERMAN NEWS FLASH

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Rough times ahead for managing directors?

German stock corporations law has recently been subject to several significant changes. In particular, the act implementing the EU directive concerning shareholders' rights (*Gesetz zur Umsetzung der Aktionärsrechterichtlinie – ARUG*) and the Act on Adequacy of Managing Directors' Salaries (*Gesetz zur Angemessenheit der Vorstandsvergütung – VorstAG*) have rephrased central parts of the German Stock Corporations Act (*Aktiengesetz*). These developments are clearly driven by a certain degree of mistrust of the companies' own capabilities to instruct and control their management and to establish transparency. For this reason, the recent changes have introduced unprecedented statutory regulations as to salary and liability of managing directors. These trends are likely to be extended even further in the foreseeable future.

Regarding managing directors' liability, there are new rules in order to ensure that the management participates in the risks it creates by running the business. According to the present German Stock Corporations Act, all D&O insurances taken out for managing directors of stock corporations must contain retained amounts of at least 10 % of the damage created and at least 1.5 times the amount of the respective annual salary. Furthermore, the adequacy of managing directors' salaries has been widely discussed in Germany. As a result, German stock corporations law now stipulates that the salary of managing directors has to be adequate and that the salary structure should encourage managing directors to focus on sustainable developments instead of short-term objectives. Notably, the members of the supervisory board are personally liable in case they approve of an inadequate salary for the management board. Apart from that, and for the first time in Germany, the salaries of the managing directors of listed stock corporations have to be disclosed to the shareholders' meeting. The shareholders' meeting may then comment on the



payments by means of a resolution. Even though such a resolution does not have any binding legal effect, this new rule contributes to more transparency within listed stock corporations.

While listed stock corporations in Germany are now adapting the agendas of their shareholders' assemblies accordingly, the new government intends to push these developments even further. According to the coalition agreement, it wants to entitle the shareholders' meeting to resolve on the cornerstones of the management board's salaries. This would constitute a genuine shift of competency within German stock corporations and could possibly include decisions on general caps as well as the extent and structure of variable remuneration.



**BY DR. JENS ENGELMANN-PILGER,
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Setting a trap for „predatory shareholders”

ARUG, the act implementing the EU directive on shareholders' rights, also aims at putting a stop to the game of so-called “predatory shareholders”. According to the definition of the German Federal Ministry of Justice, this is a species of shareholders “*who file an action in rescission against resolutions of the general meeting with the sole purpose of significantly disturbing the corporate policy of a stock corporation and subsequently abandoning their lawsuit in return for substantial financial advantages.*” ARUG complements and expands earlier legislation from the year 2005 that was meant to restrain accordingly “specialized” stockholders, but that was widely held to be inadequate to effectively prevent misuse. Abusive actions filed by predatory shareholders are capable of inflicting serious damage on the company and its other shareholders. This the case particularly when the resolution of the general meeting needs to be entered in the commercial register in order for the contemplated measure to take effect (e.g. in case of a capital increase, a squeeze-out or a corporate conversion), because the shareholder's pending action in principle prohibits the required entry. Prior to ARUG, shareholders acting in bad faith were therefore able to delay the entry in the commercial register for months and sometimes even years by filing abusive actions. Accordingly, the possibility for the stock corporation to enforce the necessary registration is at the center of the reform brought about by ARUG. The new legislation changes the law on the expedited “approval proceedings” (*Freigabeverfahren*), which can be initiated by a corporation desiring a measure to be registered in spite of a shareholder's pending action in rescission. According to the new law, the corporation's petition is to be filed directly with the Higher Regional Court (*Oberlandesgericht*) in the judicial district in which the corporation has its seat; the court's decision cannot be appealed. The judicial process is thus limited to one level of jurisdiction, whereas prior to the reform the petition was filed with the District Court (*Landgericht*), with the option of a subsequent appeal to the Higher Regional Court. It is expected that the restriction to one instance will in general halve the average duration of the approval proceedings, thus resulting in litigation lasting about three to four months. Furthermore, the corporation is now

allowed to access the records filed by the shareholder in his action in rescission directed against the measure in question even before this action has been formally served. This enables the corporation to prepare its petition for approval of entry – because it knows what the shareholder's action is about – even if the shareholder is intentionally delaying service of this action (e.g. by paying the suit money as late as possible). Moreover, the shareholder can no longer retard the service of the corporation's petition by using a foreign address, because according to ARUG the attorney designated for the shareholder's action in rescission from now on is also the authorized recipient for the approval proceedings initiated by the corporation. Small shareholders are held at bay by means of the newly introduced minimum nominal shareholding threshold of EUR 1,000 (average investment volume about EUR 10-20,000); parties with shares below this threshold can from the outset not prevent the registration of the disputed measure. As before, the corporation can base its petition on the apparent inadmissibility or lack of merits of the action in rescission filed by the shareholder. In addition, ARUG introduces the “weighing of interests” criterion. Accordingly, the disputed measure is to be entered in the commercial register, if the economic interest of the company (or its shareholders) in the measure being entered outweighs the predatory shareholder's interest in the measure not being entered. All “not negligible” economic disadvantages are to be weighed in favor of the corporation, which means that in most conceivable cases the courts are prone to rule in favor of the company.

On the other hand, a shareholder can demand that a measure is not entered in case of a “particularly serious” violation of the law, e.g. if a secret shareholders' meeting was intentionally convened without adhering to formal requirements. However, less serious infringements, as commonly invoked by “professional” claimant shareholders, will hardly convince a court to decline the entry in the commercial register. While it is not expected that the outlined changes in the law will solve all problems related to predatory shareholders, it can definitely be seen a step in the right direction. It will be interesting



to see how the reform will play out in practice, as corporations now have a strong incentive to take on predatory shareholders in court instead of acquiescing to out of court settlements.

**BY DR. REBEKKA HYE-KNUDSEN,
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Changes to Tenancy Law Envisaged under the Coalition Agreement

The coalition agreement adopted by the new German government plans a review of the existing tenancy law to assess whether it strikes the right balance between differing interests whilst maintaining its social function.

One of the changes addressed in the coalition agreement (which is, however, already the subject of disagreement within government) is to amend the notice periods in relation to residential letting. Under the existing regulations, irrespective of the term of the lease, residential tenants may terminate the agreement on giving three months' notice



to quit whereas landlords have to observe different notice periods depending on the duration of the lease (e.g. a nine month notice period applies to a lease in force for more than eight years). No decision has yet been taken whether to extend the period of notice a tenant must give or to shorten the period of notice landlords must give. Furthermore, the coalition agreement vaguely mentions that the enforceability of landlords' claims under lease agreements should be made more effective and that transfer payments earmarked as rent support should actually reach a landlord. However, the coalition agreement does not indicate how current law is to be amended to bring about these changes.

As there is considerable potential to improve the energy efficiency of buildings with desirable environmental and climate benefits, the coalition agreement furthermore envisages improving the incentive for landlords to act by reducing obstacles in tenancy law to renovation measures undertaken for energy-saving purposes. The possibilities to outsource energy supplies for rental property (*Energiecontracting*) are to be enlarged. Tenants will be obliged to tolerate any measures taken to improve energy efficiency and will not be entitled to reduce the rent in view of such measures.



**BY MAREN ROPETER,
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Climate protection and energy – the new government's plans

In respect of climate protection, Germany aims at playing a leading role on the international level. Germany's greenhouse gas emissions are therefore supposed to be reduced by 40% by the year 2020, thus supporting the effort to limit global warming to 2 degrees Celsius. In order to reach this goal, the newly elected governing coalition in Germany decided to primarily take advantage of the marketbased instrument emissions trading. Therefore, the air and sea traffic sector are to be included in the emissions trading system, while energy-intensive companies are to be exempted from the obligation to buy European Emission Allowances in order to avoid competitive disadvantages in comparison with companies situated outside the EU.

Germany also wants to strengthen its leadership in the field of renewable energies. The mechanism under the Renewable Energy Act (*Erneuerbare Energien Gesetz, EEG*) – with its feed-in tariffs and unlimited feed-in priority for energy from renewable energy sources – is maintained. However, the coalition plans to review the feed-in tariffs for solar plants next year to avoid a short-term overcompensation. Further, an amendment to the Renewable Energy Act is envisaged for 2012.

The implementation of the EU directive on CCS (carbon capture and storage), which failed this summer before the elections, is to be picked up again. Further, under the new government the operation time of the German nuclear power plants will be prolonged. Nuclear energy is considered a bridging technology providing reliable energy supply until it can be replaced by renewable energies.

In the field of energy efficiency, the new government focuses on market incentives and consumer information. The coalition further plans to support the development of so-called smart grids.



BY ANNIKA VON LA
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The German 'Zinsschranke' – Cap on the Deductibility of Interest Payments under New German Tax Legislation

On 4 December 2009, the newly elected German Parliament (*Bundestag*) adopted the first act of the current legislative period. The Act for the Acceleration of Economic Growth (*Wachstumsbeschleunigungsgesetz*) includes a bundle of measures intended to reform certain specific tax rules considered as obstacles to economic growth. The act also affects the provisions capping the deductibility of interest payments (known in German as the 'Zinsschranke') first established in 2008 under the German Corporate Tax Reform Act with a view to avoiding abusive finance arrangements in cross-border business. In the light of recent economic developments and, in particular, having regard to the needs of small and medium-sized companies, the new government has amended the rules without entirely abolishing the principles introduced by the 2008 reform.

The basic rule on the deductibility of interest payments stays the same. Interest payments, following set off against interest earnings, may be deducted from the tax base only to the extent that they do not exceed 30% of EBITDA (earnings before interest, taxes, depreciation and amortization).

The new act allows unused EBITDA to be carried forward for the following five tax years. Unused EBITDA arising in regard to

tax years beginning after 31 December 2006 and ending before 1 January 2010 may be carried forward to the first tax year ending after 31 December 2009.

The current exceptions to the rule capping the deductibility of interest payments are retained and slightly expanded in favor of taxpayers. Under the new act, interest payments not exceeding EUR 3 million are fully deductible. The exception, which was previously temporary, has now been made permanent. In addition, changes have been made to the 'escape clause' – the exception in relation to company groups by which the 30% limit does not apply if, as of the end of the previous tax year, a group company's debt-equity ratio (*Eigenkapitalquote*) is the same as or higher than the overall debt-equity ratio of the group. Under the previous rules, to avoid unnecessary hardship, a group company's debt-equity ratio was allowed to fall below the overall ratio of the group by up to 1 percentage point without affecting the operation of the escape clause. The new act extends this tolerance margin to two percentage points.

The act was approved by the Second Chamber of the German Parliament (*Bundesrat*) on 18 December 2009. It remains to be seen if the various short term measures in the act, including the changes on the deductibility of interest payments, will help to bring about the expected improvements to economic growth.



BY MAREN ROPETER,
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Inside MSA

PERSONAL NEWS

Maria Wolleb has been elected equity partner. Maria is the managing partner of the firm's Berlin office with a practice focused on real estate and company transactions. +++ *Oliver Cleblad* of the Frankfurt office has been elected local partner. He advises in the field of M&A (mergers and acquisitions) as well as in corporate and commercial matters.

SEMINARS AND CONFERENCES

On 10 December 2009, Mannheimer Swartling hosted an exclusive private view of the Visual Voltage exhibition currently being presented at the Swedish Embassy in Berlin. The well-attended event included a panel discussion on current topics of energy efficiency, real estate and technology that was moderated by Annika von La Chevallerie, specialist counsel for energy and environmental law in Mannheimer Swartling's Berlin office.

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