

On the Subject

Update from Germany

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- Introduction of a 20 percent flat tax on capital gains from the disposition of private assets (especially stocks, commercial paper and real estate) and abolishment of the currently applicable speculative taxation (pursuant to which the sale of assets is completely tax exempt) once the applicable speculative period has expired; the new flat tax will apply to assets acquired prior to January 1, 2007 and then to betterments realized from January 1, 2007 onwards.
 - Reduction of the unemployment insurance contribution from 6.5 percent to 4.5 percent concurrent with an increase of the statutory pension insurance contribution from 19.5 percent to 19.9 percent.

The Grand Coalition: Prospects for Tax Reform

On November 11, almost two months after the inconclusive national elections, the Christian Democratic Union and the Christian Social Union (CDU/CSU) and the Social Democratic Party (SPD) sealed their agreement to govern together in a "grand coalition." On November 22, Angela Merkel, the leader of CDU/CSU, was elected as the first German female chancellor.

In addition to the reduction of unemployment and other matters, the coalition agreement focuses on consolidating and balancing Germany's budget, in particular through reform of the German tax system. The following summarizes the key aspects of the intended tax reforms from an international investor's perspective.

Intended Changes Effective January 1, 2007

- Increase of the regular value added tax (VAT) rate by three points to 19 percent (the reduced VAT rate is intended to remain at 7 percent).
 - Introduction of a so-called "rich tax" applicable to German taxpayers earning €250,000 (€500,000 for married couples) or more, resulting in an increase of their income tax rate by three points to 45 percent on the earnings exceeding these thresholds.
- Uniform taxation of business entities regardless of their legal form, which will comprise a noticeable reduction of tax rates (although this reduction is not intended to result in an overall net relief).

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Other Intended Changes

- Introduction of a rule prohibiting investors from offsetting losses arising from prearranged ventures (exceeding 10 percent of investors' capital contribution in the initial phase) against other income but allowing them to offset against future profits of the investment; retroactively applicable to all investments signed after November 10, 2005 or when the placement has started after the same date and applicable to certain kinds of short-term trading assets as well as closed funds, especially film and media financing and wind farms.
- Business entities investing in machinery and other assets may claim declining-method depreciation for these assets at 30 percent (instead of the current 20 percent rate), which corresponds with a total abolishment of declining-method depreciation for rented apartments.
- Heirs continuing a business will be relieved from inheritance and gift tax by one-tenth of the applicable tax for each year they continue the business and preserve jobs (*i.e.*, if a business is continued for ten years, there is 100 percent relief beginning in 2007).

- General tax conditions for investments in venture capital will be improved.

The process for implementation of the first tax reforms, mostly concerning the taxation of private individuals, has already begun. The majority of the intended reforms, however, will only be negotiated and discussed in detail and introduced in the legislation process sometime next year or in 2007.

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Improved Legal Protection for Investors

Effective as of November 1, 2005, the new Capital Markets Model Case Act (*KapMuG*) improves the legal protection of investors. The *KapMuG* is designed to provide better prospects for investors to claim damages due to false, misleading or omitted public capital markets information. This includes information contained in or omitted from prospectuses under the Securities Prospectus Act, sales prospectuses under the Sales Prospectus Act and the Investment Act, and communications of insider information, presentations, overviews, lectures and information on the state of the company, including relationships with associated enterprises. Further, annual financial statements, annual reports, group financial statements, group annual reports, interim reports of the issuer and offering documents within the meaning of section 11 (1) of the Securities Acquisition and Takeover Act are included.

The *KapMuG* is intended to facilitate the interests of all parties involved in securities litigation, e.g., the investors, the courts and the sued companies. It contains several formal provisions leading to a faster and easier execution of lawsuits regarding capital market matters. The new law provides parties with an alternative method to claim damages within model case proceedings due to false or misleading capital markets information. Identical legal questions that arise in at least 10 individual lawsuits may be combined in one model case proceeding at the Higher Regional Court. The decision of the court regarding this particular issue will be effective and enforceable to all complainants of the individual lawsuits, which is intended to improve the efficiency of proceedings.

The expected advantages of the *KapMuG* are as follows:

- Investors may enforce their claims more effectively.
- Complex legal questions may be resolved in just one lawsuit, and only one hearing of evidence is required.
- Individual investors' legal expenses may be lowered.

- The courts will have to deal with fewer lawsuits regarding capital market matters.

The first model case proceedings system in German law was created by *KapMuG*. As this is a new area of legislation, the effectiveness of the *KapMuG* is initially limited to five years. After this time period, the Federal Ministry of Justice intends to analyze the effects of such proceedings. It remains to be seen whether the intended advantages will be realized in practice.

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Restrictions on Challenges to Shareholders' Resolutions

In the past, the German Act on Stock Corporations (*Aktiengesetz*) gave minority shareholders a disproportionate opportunity to challenge and thereby delay the implementation of certain shareholders' resolutions registered with the commercial registry (such as capital measures, squeeze-outs and mergers). Often legitimate business decisions were put at risk by a group of minority shareholders with immaterial shareholdings because there was no threshold or other hurdle for the exercise of the right to challenge shareholders' resolutions. This group of "professional" minority shareholders became feared and loathed as they traveled from general meeting to general meeting to find faults in the procedure or the content of shareholder resolutions (see "Why Germany Needs Shareholder Reform," IFLR February 2005, page 17/18, available at www.mwe.com/info/pubs/germany0205.pdf). The shortcomings of the old law are illustrated by the blocking of the merger of DAX-member Deutsche Telekom AG with its publicly listed subsidiary, T-Online AG by various shareholder challenges.

Statutory changes to the *Aktiengesetz*, effective on November 1, 2005, have severely restricted such challenges. Under the new provisions, a challenge to resolutions because of an alleged violation of information rights will only be successful if the suing shareholder was a shareholder when the invitation and the agenda for a shareholders' meeting were published. As this by itself likely will not be sufficient to deter frivolous lawsuits, the law also requires that an objective shareholder would have deemed the insufficient or incorrect information to be "material" for the suit to be legal. It is therefore not sufficient to claim any relevant information was withheld or any information provided was incorrect. The relevant information must have such importance that an objective shareholder would not have approved the resolution had he known the full and correct information. However, it is not necessary that the majority of the voting shareholders would have disapproved the measure.

Resolutions were challenged because companies did not provide sufficient information on the calculation of compensation payable to shareholders in connection with resolutions affecting ownership rights. Now, the procedure and the content of such compensation decisions will, in most matters, be exclusively reviewed by a separate appraisal rights procedure (*Spruchverfahren*), which will not delay the implementation and registration of any resolution.

If a shareholder lawsuit is filed, the new law provides that the management of the corporation can file an application for clearance in a newly created procedure known as *Freigabeverfahren*. The court that determines the legality of the shareholders' resolution and its challenge will have to determine whether or not the pending lawsuit will delay the registration of the respective measure. Clearance will be provided if the court decides the shareholder challenge is unjustified or if the interest of the corporation in the implementation of the measure is more significant than the potential harm to a shareholder. If clearance is given, a registration in the commercial register can no longer be challenged by shareholders. Even if the court would later find the challenge was in fact justified, the litigating shareholder could only seek damages. The shareholder cannot demand that the commercial register "correct" the registration that was based on an illegal shareholders' resolution.

Finally, if shareholder lawsuits are settled, the management board of the corporation must immediately publish information on the type of termination as well as the entire text of any related agreement between the suing shareholder and the corporation. Publication should further deter "professional" minority shareholders from bringing lawsuits, the sole purpose of which is to force the company to make payments in order to terminate the proceedings.

With these new provisions, "professional" minority shareholders may have become an endangered species, which should be welcome news to most if not all stock corporations and their other shareholders.

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New Law on Public-Private Partnerships

The new law on the acceleration of the realization of public-private partnerships (PPPs) amends several existing laws in order to effectively foster the implementation of PPPs in Germany.

PPPs are intended to be continuous cooperations between public authorities and private enterprises to the mutual benefit of each party with respect to the performance of public services. In this setting, public authorities often merely act as the requester for public services, and private enterprises perform them.

As a result of a reassessment of the traditional division of work between public authorities and private enterprises and limited public budgets, the future establishment of PPPs is deemed necessary to maintain current public services and to cope with the constant demand for new infrastructures throughout Germany.

It has been observed in other European countries that, through the establishment of a PPP, it is possible to provide public services not only cheaper and faster, but also at a superior level of quality. Costs are reduced by 10 to 20 percent of the traditional cost of infrastructural projects.

Areas of public services where PPPs are typically used include the construction of different types of public buildings (administration offices, schools, hospitals, sports venues, *etc.*), roads and other transportation facilities. Recently, the German Federal Minister of Transport, Building and Housing decided to establish PPPs to expand five sections of the Autobahn network with an estimated overall investment of € 1.2 billion. Private enterprises are expected to construct, operate and maintain the respective Autobahn sections—refunding will take place via the collection of truck tolls by the private enterprise.

The new law is designed to provide a legal framework that encourages the establishment of PPPs by eliminating legal restraints and ambiguities. The following summarizes amendments made to different areas of law.

Several amendments affect the public procurement laws. In the past, German courts required any private contractor taking part in an award procedure to perform a substantial amount of the obligation through his own staff and production facilities. This constituted a considerable hindrance for financial investors or bidding consortiums to effectively compete for public contracts as they usually rely on third parties' capabilities to perform their obligations. The Regulation for Awarding Contracts (*Vergabeverordnung*) has been amended to allow private contractors competing in an award procedure to have subcontractors actually perform the respective services due. Another issue was fairness of award procedures. Prior to their initiation, public authorities usually are advised by a private enterprise, who then becomes a potential competitor in the upcoming procedure. A newly introduced provision of the *Vergabeverordnung* obliges public authorities to thoroughly observe the award procedure and to make sure that competition

is not tampered with or influenced by an unfair competitive edge with respect to information the advisor has gained.

In order to give the public authorities a higher degree of flexibility, the Federal Budgetary Regulation (*Bundshaushaltsordnung*) has been amended to allow the sale of real property necessary for the performance of public duties to private enterprises if it can be shown that private enterprises can accomplish these duties more efficiently. In order to make this possible, certain provisions of tax law were altered. Both the Real Property Transfer Tax Act (*Grunderwerbssteuergesetz*) and Real Property Tax Act (*Grundsteuergesetz*) have been revised to facilitate the transfer of real property to PPPs. For instance, no real-property-transfer tax will be assessed if real property is transferred from public authorities to a private enterprise in the course of a PPP provided that the parties agree the real property will be transferred back after the expiration of the PPP's term. Further, no real-property tax will be assessed if a private enterprise cedes real property to a public authority provided the real property will ultimately be transferred to the public authority after the expiration of the PPP's term.

With respect to the operation of Autobahns or other road networks, the contractor is explicitly entitled to choose whether he wants the procedure of levying truck tolls to be governed by public or private law pursuant to a newly amended section of the Act on Private Financing of Highway Constructions (*Fernstraßenbauprivatfinanzierungs-gesetz*). Either way, the specific amount of the tolls is monitored and has to be approved in advance by the appointed authorities.

The Investment Act (*Investmentgesetz*) has also been amended to enlarge investment opportunities for open real estate funds. Such funds are now allowed to acquire usufruct rights in real property once the operational phase of the PPP project has begun. However, such overall investments in usufruct may not exceed 10 percent of the fund.

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European Harmonization Simplifies Clinical Trial Process

Until recently, prepatent expiry testing work was not harmonized by European law. This created significant differences as to whether clinical trial work conducted for generic drug approval was considered patent infringement according to the individual national laws of the EU Member States. Due to the significant differences for clinical trial exemption in the national law, the harmonization of preexpiry testing is considered an important tool to balance innovators' research and

development interests for new medicinal products with the desire of the public to reduce health care costs and ensure access and affordability. For this reason the European Union introduced an experimental-use exemption in Directive 2001/83 in 2004. Following the legal terminology of the U.S. case *Roche Products Inc. vs. Bolar Pharmaceuticals Corp. Inc.*, this exemption is also referred to as the "Bolar-type exemption" or "Bolar-type provision." This new directive had to be implemented by the Member States by October 30, 2005 at the latest.

Scope of the Bolar-type Exemption

Article 10 (6) of the Directive 2001/83 provides for an exemption from patent infringement regarding preclinical and clinical experiments and trials that are carried out in order to obtain regulatory approval for human medicinal products for the European Union. Unfortunately, the scope of the Bolar-type provision is not fully clear. Obviously, any work carried out to obtain any regulatory approval for generic applications seems to be covered by the Bolar-type provision. However, it is not clear whether the Bolar-type provision also covers clinical trials in general, such as those for competing innovator products, for example.

Implementation into the National Laws of the EU Member States

The implementation of the EU directive does not necessarily have to be identical in every Member State. Member States are only obliged to adapt their national laws to the minimum requirements of an EU directive. Accordingly, subject to Directive 2001/83, the Member States only have to introduce a Bolar-type exemption that is restricted to generic applications. However, each Member State is free to voluntarily implement a broader exemption which permits clinical testing for all human medicinal products into their national legislation.

German Implementation

On September 6, 2005 the Bolar-type exemption of the EU Directive 2001/83 was implemented into the German Patent Act. Section 11 no. 2(b) of the German Patent Act exempts all studies and trials that are necessary to obtain marketing approval for the European Union or for one of the Member States. The wording of the Bolar-type exemption of the German Patent Act extends beyond the scope of Directive 2001/83. Further to studies relating to generic applications, it seems to include all studies and trials necessary to obtain a marketing authorization. Although the production of clinical trial material is not explicitly permitted by section 11 no. 2(b) of the German Patent Act, the legislature's reasoning suggests that such production be covered by the provision as long as it is necessary to conduct the studies and trials.

Outlook

By implementing Directive 2001/83, Germany has not incorporated the wording and ambiguities of the European Bolar-type exemption; rather, it has added detail to determine the scope of the provision and to prevent future legal uncertainties. Despite these clarification efforts, details of the scope of the German Bolar-type provision still need to be assessed by the German jurisdiction.

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Sarbanes-Oxley Hotlines v. German Labor and EU Data Protection Laws

A recent case involving German subsidiaries of Wal-Mart Stores, Inc. highlights the difficulties U.S.-listed multinationals have in developing a global compliance program. In particular, problems have arisen in the context of Sarbanes-Oxley (SOX) whistle-blowing provisions and the processing and transfer of personal data. EU employees have certain protections that U.S. employees of U.S.-listed companies do not; SOX whistle-blowing procedure can conflict with EU law where they make reporting of concerns mandatory, encourage anonymous reporting and do not require employers to promptly notify an alleged offender.

The potential conflict came to light in France last May, when the SOX whistle-blowing procedures of a subsidiary of McDonald's Corporation and another U.S. listed company were found to be in violation of French data protection laws in its compliance with SOX whistle-blowing procedures. French authorities in November issued guidance on how to comply with both. The main principles of this guidance include limiting whistle-blowing procedures to auditing, accounting and similar specified concerns, defining these procedures as voluntary rather than compulsory, discouraging anonymous reporting, processing anonymous reports with specific precautions, designating a specific processing entity and notifying the alleged wrongdoer identified in the report (see "The Challenge Of Harmonizing U.S. Codes Of Conduct and Sarbanes-Oxley Hotlines with EU Data Protection and Employment Laws" December 7, 2005, available at <http://www.mwe.com/info/news/ots1205c.htm>).

The legality of Wal-Mart's SOX whistle-blowing procedures and other code of conduct provisions came into question when the works councils of Wal-Mart's German subsidiaries challenged the validity of several aspects of a new code of business conduct and ethics. Wal-Mart did not request the agreement of the subsidiaries' works councils, and the councils raised the issue with the Labor Court of Wuppertal.

On June 15, 2005, the Labor Court held that several provisions of the code were subject to negotiation with the works council before implementation and, since that had not occurred, were invalid. Wal-Mart appealed the Labor Court's decision to the District Labor Court in Düsseldorf, which, on November 14, 2005, held that the following sections of the code were invalid as the works council's co-determination rights had been violated:

- Introduction and use of telephone hotline.
- Taking of gifts and contributions.
- Harassment and other unacceptable behavior (other than concerning violence at the worksite or on the job).

Both sides have the right to appeal to the German Federal Employment Court and it remains to be seen whether the Wal-Mart code or other codes are challenged on the basis of a violation of German data protection law, in particular with regard to the potential transfer of employee-related data to another country (*e.g.*, the United States) or to an external third person wherever located.

While no specific data protection violation cases have to date occurred in Germany, trends in Europe suggest they eventually will. Accordingly, multinationals should evaluate their SOX whistle-blowing procedures and codes of conduct against relevant Member State data protection and labor laws and monitor further developments.

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McDermott Will & Emery News from Germany

McDermott Named Law Firm of the Year for Media

McDermott's German practice won the prestigious JUVE award for Law Firm of the Year for Media. Our Telecom, Media & Technology Practice Group (TMT) in Germany is led by partners Dr. Ralf Weisser, Dr. Oliver Steffens and Dr. Wolfgang von Frentz. The TMT Group was presented with the award on October 27, 2005 by JUVE, the leading publisher in the German legal market.

JUVE commented the Firm's TMT Group has firmly established itself in the market after only four years and further reported the group's rapid expansion, organized by team leader Dr. Ralf

Weisser, has contributed to the group's success in this competitive market. The group also includes partners Claudia Sendlbeck-Schickor and Oliver Kächele, who are well-known in the area of tax and film financing.

The Firm's TMT Practice Group provides a full range of legal services on corporate, M&A, commercial, regulatory, litigation and financing matters to all companies operating in Europe's TMT industries. It represents clients in the mobile and fixed line telephony, fiber optics, DSL, cable and satellite TV, media, broadcasting, entertainment, film production and distribution, film financing, merchandizing, IT, software, hardware, outsourcing, telematics, technology developments, internet and e-commerce industries as well as financial institutions with interests in these industries.



Dr. Ralf Weisser accepts JUVE award from presenters.

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