

1993

Germany

Recommended Citation

Germany, 27 INT'L L. 218 (1993)

<https://scholar.smu.edu/til/vol27/iss1/14>

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joined, however, unless it is expressly excluded, the Convention will govern all commercial contracts for the sale of goods with the United States.

The Convention creates basic rules to govern international contractual relationships for the purchase and sale of goods that may differ from those provided by domestic law. Therefore, its provisions are important for those companies involved in international trade. The Convention contains detailed rules on various aspects of sales contracts such as the offer and its acceptance, the rights and obligations of the parties, and the remedies available to the parties in the event of a breach of contract. Furthermore, the Convention contains provisions that endeavor to incorporate the practices and usages that parties have already established between themselves. The intent of the Convention is to eliminate some of the uncertainty in international sale of goods transactions and to avoid, to some extent, the conflict in such transactions as to the governing law. The interpretation of the Convention in conjunction with preexisting legislation may result in uncertainty. However, the Convention would exclude or prevail over any rule that is inconsistent with it, to the extent of the inconsistency.

Because the Convention is a compromise between the world's various legal systems, it contains a number of principles that vary with those of the common law provinces of Canada. For example, the limitation period for the commencement of a breach of contract action is two years rather than the longer periods called for in the various provincial statutes of limitation. While all these variances may be significant, the Convention does provide a reasonable, neutral alternative to the question of which law will govern a contract between parties located in different countries.

Germany*

I. East-West German Integration

A. PRIVATIZATION

During 1991 and 1992, the Berlin-based Treuhandanstalt, the government agency in charge of privatizing the formerly socialist eastern German businesses,

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has continued its rigid policy of privatization.¹ By mid-1992, over 7,000 out of the approximately 11,000 socialist businesses, or roughly a third, had been sold to private investors. As a result of this, the agency has begun to close down some of its regional offices since its management now considers its task accomplished.

Yet at the end of the day, many businesses, particularly in difficult industries such as low-tech textiles, chemicals, or mining, are likely to be left over from the process. As of now, the German Government has not finally determined whether the Treuhandanstalt may survive longer than originally anticipated, perhaps in the form of a state holding company, until the time has come to privatize or liquidate the remaining businesses.

B. PROPERTY LEGISLATION—SECOND AMENDMENT TO PROPERTY ACT ENACTED

One of the many issues raised by the process of German unification and integration had been the resolution of eastern German property issues. The centerpiece of legislation addressing these issues is the Act Concerning the Settlement of Open Property Issues, or Property Act, which was adopted in connection with the Unification Treaty in the fall of 1990. The Property Act established the principle that expropriation measures carried out by the Nazi or the East German Communist authorities are to be rectified; property items, including businesses, taken illegally are to be returned to the rightful owners. Only where this is not possible, or property was substantially changed or acquired in good faith, or where the claimant so elects, the property is not to be returned and previous owners are to receive compensation. To allow investors to override the prohibition of dispositions of property where restitution claims have been filed, the Act Regarding Special Investments in the Former Territory of East Germany was adopted together with the Property Act itself.² According to this Act, local authorities may issue special exemptions from the prohibition to sell property that may be the subject of restitution claims if the sale serves special investment purposes. In 1991, the Act to Remove Investment Obstacles³ further expanded the priority rule favoring investors. This law allows authorities that have become the owners of record of real estate to grant investors a certificate of title if they present a viable investment project.

Another major amendment of the Property Act has now been adopted.⁴ While the general principles will remain intact, the amendment attempts to limit further

1. For an in-depth report on the Treuhandanstalt, see Paul Dodds & Gerd Wächter, *Privatization Contracts with the German Treuhandanstalt: An Insiders' Guide*, *supra* p. 65.

2. Gesetz über besondere Investitionen in dem in Artikel 3 des Einigungsvertrages bezeichneten Gebiet, Unification Treaty, Exhibit II, ch. III, § I (1).

3. Gesetz zur Beseitigung von Hemmnissen bei der Privatisierung von Unternehmen und zur Förderung von Investitionen in den neuen Bundesländern, BGB1. I at 766.

4. Zweites Vermögensrechtsänderungsgesetz [Second Act Amending Property Law] of July 14, 1992, BGB1. I at 1257.

the reach of the restitution principle in order to facilitate investments and alleviate technical problems that have been encountered in the application of the Property Act. In particular, all rules dealing with the priority of investors have been consolidated in the new Investment Priority Act.⁵ Besides expanding the reach of the priority rule and expediting the restitution procedure, having a separate piece of legislation will make the priority law more accessible and easier to administer. The amendment also introduced cutoff dates for the filing of property claims. Claims for the return of real estate and businesses must be filed by December 31, 1992, and claims to movable property, by June 30, 1993.

C. COMPENSATION ACT STILL AWAITS ADOPTION

The Property Act, even in its revised 1991 and 1992 versions, covers the issue of compensation only in a general way without giving any precise numbers or describing methods of calculation. These have been left to be resolved in a separate Compensation Act.

Until now, only certain principles of compensation have emerged that are likely to become part of the new law. Where restitution is excluded, owners will receive a multiple (such as 1.3 times) of the unitary tax value as of 1935. According to government officials, this calculation may amount to 20 to 25 percent of the current market value. In addition, a deduction will be made for amounts over and above certain thresholds.⁶ Since this will result in compensation amounts substantially below market value, recipients of returned property will have to pay a one-time duty of a certain percentage of the market value. Thus, they will also have to share part of the burden and, at the same time, help finance the payment of compensation.

The Compensation Act is expected to be enacted as soon as the members of the governing coalition have agreed on the financial principles of compensation. As of this date, no precise time frame has been given for the adoption of this Act.

D. U.S.-GERMAN LUMP SUM SETTLEMENT AGREEMENT SIGNED IN MAY 1992

As of May 13, 1992, the Agreement Between the Government of the United States of America and the Government of the Federal Republic of Germany Concerning the Settlement of Certain Property Claims has given U.S. claims special treatment. This Agreement ended what one might duly call an odyssey of governmental negotiations, which were commenced back in the 1970s.⁷

5. Investitionsvorranggesetz.

6. Earlier proposals had stated that 10 percent would be deducted from compensation amounts of more than DM 100,000, but less than DM 300,000; that 20 percent would be deducted for amounts of between DM 300,000 and DM 500,000; 30 percent of amounts between DM 500,000 and DM 1,000,000; and 40 percent of amounts over DM 1,000,000.

7. For details, see William K. Wilburn, *Filing of U.S. Property Claims in Eastern Germany*, 25 INT'L LAW. 649 (1991).

In 1976, the U.S. Congress had enacted a new Subchapter to the International Claims Settlement Act dealing with claims against the German Democratic Republic. This Act authorized the U.S. Foreign Claims Settlement Commission to receive claims by U.S. citizens and companies, which were to be settled by the then still existing German Democratic Republic under a lump sum settlement agreement yet to be negotiated. Under this legislation, approximately 1,900 awards were issued, but remained unfunded because the negotiations were not concluded until now.

The Agreement gives U.S. claimants, who participated in the U.S. claims procedure and received an award, the option to pursue their claim either under the Agreement or in accordance with German internal law. It provides that the U.S. authorities will notify the U.S. claimants of the contents of the Agreement and ask them to make their choice by a certain date. If they do not respond, they will be presumed to have opted for the lump sum procedure. The total sum notified to the U.S. authorities will be communicated to the German Government, which will pay the sum so that the U.S. can distribute the money to the U.S. claimants.

Some U.S. claimants will confront a difficult decision since in principle three remedies may be available to them: return of property under the German Property Act; monetary compensation under the German Property Act yet to be enacted (in particular where the return of property is excluded); or monetary compensation under the U.S.-German lump sum Agreement. Those who have an actual choice will have to weigh their options carefully.

II. Corporate Law

A. NEW DECISION ON PIERCING OF THE CORPORATE VEIL DOCTRINE

In a new case dealing with the concept of shareholder liability in a group of companies context, the Federal Supreme Court continued its line of cases expanding the liability of the dominating shareholder for the debts of its limited liability subsidiary.⁸

The facts of the case, which was first decided by the district court and then the court of appeals of Cologne, were reported earlier in this series.⁹ In upholding the court of appeals, the Federal Supreme Court held that where a shareholder owns and manages several companies in similar lines of business and pursues an overall group strategy, the shareholder may be held personally liable if one of the companies goes bankrupt.

In summarizing the current German law of shareholder liability, clearly the German concept of piercing the corporate veil has become much broader than in other legal systems such as that of the United States. To avoid the imposition of

8. Bundesgerichtshof, Sept. 23, 1991, BGHZ 115, 187 (Video).

9. See Burkhard Bastuck, *Regional Developments—Germany*, 26 INT'L LAW. 227, 228 (1992).

shareholder liability, simply obeying corporate formalities and keeping corporate assets separate are no longer sufficient. In order to limit the risk that liability will be imposed on the parent, foreign owners of German corporations should implement a policy of subsidiary autonomy to the extent possible, refrain from becoming involved in the day-to-day affairs of the subsidiary, and avoid overlapping directors and managers.

B. IMPLEMENTATION OF EC ONE-MAN COMPANY DIRECTIVE

In its 12th Company Directive, dubbed the "One-Man Directive,"¹⁰ the EC established the principle that limited liability companies could be formed by only one shareholder. As this principle had long been part of German corporate law and practice, only few changes were necessary to bring the GmbH-Gesetz into line with EC law. To implement the 12th Directive, section 35, subsection 4 of the GmbH-Gesetz was amended¹¹ to require that any transactions between the shareholder and the company be entered into the minutes of the company immediately upon their conclusion.

This principle is likely also to apply to a German subsidiary of a foreign GmbH if the managing director of the GmbH at the same time is authorized to act for the foreign shareholder. This formal requirement should be strictly observed since noncompliance may have very negative consequences both as far as the limitation of liability and taxes are concerned.

III. Tax Law

A. TAX TREATMENT OF SHAREHOLDERS' LOANS IN LIEU OF CAPITAL

Shareholders' loans in lieu of capital¹² have a double significance in the financing of a GmbH. First, shareholders are deemed to have infused debt in lieu of capital where the company was so undercapitalized as reasonably to require an equity infusion and, therefore, will not be able to enforce their claim for repayment of debt in the company's bankruptcy.¹³ Second, where a negative net worth position is impending, bankruptcy may be avoided by voluntarily recharacterizing shareholders' debt as equity, which would take it out of the liabilities side of the balance sheet for the purpose of determining net worth.¹⁴

While in each case a recharacterization of capital infusions for corporate law purposes occurs, the effect on the tax treatment has remained unclear. In a recent

10. Council Directive of Dec. 22, 1989, 1990 O.J. (L 395) 40.

11. Act of Dec. 18, 1991, BGBI. I at 2206.

12. Kapitalersetzende Darlehen.

13. See §§ 30, 31, 32a & 32b of the GmbH-Gesetz.

14. This is usually accomplished through a declaration of subordination of debt (Rangrücktritts-erklärung).

decision the Federal Tax Court ruled on the tax treatment of such funds.¹⁵ According to the court, shareholders' loans remain loans for tax purposes irrespective of their characterization for corporate and bankruptcy law purposes. Accordingly, any interest paid (to the extent this was still possible and allowed) is deductible as a business expense and does not constitute a constructive dividend, which would have serious consequences under German tax law. The court explicitly stated that this was also true under applicable double taxation treaties.

B. TAX TRANSFORMATION ACT

The German legislature has now implemented the EC Directive on Cross Border Mergers.¹⁶ New section 20, subsection 6 of the Transformation Act¹⁷ allows an exchange of shares held in corporations having their seat within the EC without imposing any taxes, provided that any additional consideration paid does not exceed 10 percent of the nominal value of the shares. In addition, section 20, subsection 8, provides that businesses or parts of businesses may be contributed to a domestic or foreign branch of a corporation having its seat in an EC country other than Germany in exchange for shares, and that no income taxes will be levied on the transactions. The same applies in the opposite direction.

C. EC PARENT COMPANY/SUBSIDIARY DIRECTIVE

To implement the EC Parent Company/Subsidiary Directive,¹⁸ the German legislature has introduced new section 44d into the Income Tax Code. This section provides that until June 30, 1996, the withholding tax on dividends paid by a German subsidiary to its EC parent company will be reduced from 25 percent down to 5 percent upon the parent company's application. This reduction applies ordinarily when the tax is paid by the parent, but the reduction is to only 5.26 percent if it is paid by the subsidiary. After June 30, 1996, withholding tax will cease to exist. To benefit from the reduction, the parent company must have owned at least 25 percent of the shares of the subsidiary during the twelve months preceding the distribution. Under certain circumstances, the relevant threshold is reduced to 10 percent.

At the same time, the Trade Tax Law¹⁹ has been amended to exempt dividends paid by an EC subsidiary to its German parent company from trade tax.

D. LEGISLATION ON INTEREST INCOME WITHHOLDING TAX

To fulfill a mandate imposed by a decision of the Federal Constitutional Court that questioned the fairness of the current tax system, the German legislature has

15. Judgment of Feb. 5, 1992, *DER BETRIEB* 763 (1992).

16. Council Directive 90/434 of July 23, 1990, 1990 O.J. (L 225) 1.

17. *Umwandlungssteuergesetz*, amended by Act of Feb. 25, 1992, *BGBI. I* at 297.

18. Council Directive 90/435 of July 23, 1990, 1990 O.J. (L 225) 6.

19. Amended § 9(7) of the Trade Tax Law (*Gewerbsteuergesetz*).

decided to introduce a 30 percent withholding tax on interest income, effective January 1, 1993. The tax applies to all interest income from securities such as bonds, time deposits, and savings. The tax will be collected by banks and remitted to the tax authorities. Individual taxpayers will be able to deduct taxes withheld from their overall tax bill. The first DM 6,000 (DM 12,000 for married couples) of interest income are exempt from income tax and, upon presentation of an exemption certificate to the bank, will not be withheld.

The new regime does not affect foreigners, as the tax will not be withheld if the taxpayer resides outside of Germany.

IV. Courts

A. RECOGNITION OF U.S. JUDGMENTS

The Federal Supreme Court added another chapter to the judicial conflict between the United States and Germany by failing to fully recognize a California judgment awarding exemplary and punitive damages. The petitioner, a U.S. citizen living in California and the plaintiff in the original action, had obtained a California civil judgment against the respondent/defendant, a U.S. and German citizen who had engaged the plaintiff in homosexual activities while the plaintiff was still a minor. The California court awarded \$750,260 in damages, consisting of \$260 for the costs of medical treatment, \$150,000 for the costs of psychiatric treatment, \$200,000 for pain and suffering, and \$400,000 in punitive damages. After the defendant, who at the time had lived in California, moved to Germany, the plaintiff tried to enforce the judgment in Germany. In its decision of June 1992, the Federal Supreme Court recognized the California judgment only in the amount of \$350,260, thus denying recognition of the \$400,000 award of punitive damages.²⁰

The court stated that to enforce the judgment as far as exemplary and punitive damages were concerned would be incompatible with German public policy because contrary to U.S. law, the policy underlying the German civil law of damages was to compensate the harmed person for injury and loss, but not to punish the perpetrator or deter others. Although it noted that a German court might have awarded damages for pain and suffering only in the area of DM 30,000, the court did recognize the \$200,000 award of damages for pain and suffering. In support of this finding, the court considered that when the wrongful actions took place, both parties lived in California and were thus familiar with California's laws of compensation for pain and suffering, as long as the awards were not clearly excessive. In this context, the court left open the question whether different considerations would have applied if the facts had borne a closer relationship to Germany. Commentators have noted that this leaves the door open for a different

20. Judgment of June 4, 1992, 1992 NJW 3073.

ruling in a products liability case where stronger German interests may be at stake.

V. Environmental Law—New Commercial Waste Management Rules

The German Government is undertaking more and more measures to prevent and reduce waste. Packaging waste has now, for the first time, been tackled by means of the Ordinance on the Avoidance of Packaging Waste, which entered into effect in June 1991.²¹

The Ordinance sets out requirements for the manufacture of packaging from materials that are environmentally compatible and that do not prejudice the recycling of materials. Furthermore, packaging waste must be avoided by ensuring that the packaging is restricted in volume and weight, that it is designed in such a way as to make it fit for refilling (provided this is technically possible and reasonable), and that it is recycled where the requirements for refilling cannot be met.

A new system of waste management should attain these objectives. To this end the Packaging Ordinance defines three kinds of packaging. The first type is transport packaging, which is defined as packaging that serves to protect goods from damage while in transit from the manufacturer to the distributor, or that ensures safety during transport. Some of these package types include barrels, canisters, boxes, sacks including pallets, cardboard boxes, foam-filled receptacles, shrink-wrapping, and similar coverings. Secondary (display) packaging is defined as additional packaging around another packaging. Such packaging allows goods to be sold on a self-service basis, or to reduce or prevent the risk of theft, or to help in advertising for the product. The last category is sales packaging, which are the closed or open receptacles and coverings of goods used by the end-user to transport goods until they are consumed.

As of December 1, 1991, manufacturers and distributors of transport packaging can no longer ship used transport packaging to the existing public waste management system, but are now required to accept the return of used transport packaging and to reuse or recycle it. The same provision applies to secondary (display) packaging from April 1, 1992, and to sales packaging from January 1, 1993. The German Government is attempting to implement a new, private system of waste management through these obligations to accept returned packaging. To alleviate the logistic and administrative burden on manufacturers and distributors, the Ordinance allows them to contract the recycling out to private contractors.

This also applies to sales packaging, with a few significant differences. Manufacturers and distributors may contract the recycling out to third parties only if

21. Verordnung über die Vermeidung von Verpackungsabfällen (Verpackungsverordnung) of June 12, 1991, BGBI. I at 1234.

the waste management system has been approved by the authorities. The system must absorb certain annual average percentages of the total amount of packaging materials given as a percentage by weight. For instance, as of January 1, 1993, the system will be approved only if it collects 60 percent of the total amount of glass used as packaging.²² A further requirement for this private system is that certain kinds of the collected substances must be extracted in a form suitable for recycling. Eventually, the operators of the system will have to reuse and recycle all packaging.

Companies importing goods into Germany also come under the rules of the Packaging Ordinance if they bring packaging and packaged products into circulation in Germany. This is the case where goods are delivered to German subsidiaries of foreign manufacturers. If a foreign company delivers goods to other companies outside Germany first, the Ordinance does not apply.

VI. Trademarks

A. NEW LEGISLATION TO LIBERALIZE TRANSFER OF TRADEMARKS

On May 1, 1992, the Act Concerning the Expansion of the Validity of Industrial Property Rights²³ entered into effect. By virtue of this Act, the geographical area where western or eastern German intellectual property rights are recognized is extended to the entire territory of Germany, including the area that formerly belonged to the other German state. On collisions, which are expected to occur in many instances, the Act distinguishes between patents on the one side and trademarks on the other. While disallowing any patent infringement action that may be brought by the alleged holder of an older right, the Act requires that trademarks conflicting with trademarks in the other territory be used only with the consent of the owner of the conflicting right.

Even though the primary purpose of the new Act was to resolve issues in the wake of unification, it contains another feature that will be of paramount significance for the corporate and intellectual property right practitioner. In the past, trademarks could not be separated from the business in which they were used and could be transferred only along with the business concerned. This principle has been abolished. According to new section 8 of the Trademark Act,²⁴ trademarks may be transferred irrespective of the business in which they were created. As a result, trademarks are likely to become more of a commodity and may also be centralized in a holding company even if the business is conducted elsewhere in the group.

22. From July 1, 1995, onward, a percentage of 80 percent of glass must be reached. The corresponding percentages for cardboard and paper are 30 percent and 80 percent, respectively.

23. Gesetz über die Erstreckung von gewerblichen Schutzrechten—Erstreckungsgesetz, BGBI. I at 938.

24. Warenzeichengesetz.

VII. Attorneys

A. LIBERALIZATION OF ETHICAL STANDARDS

After several years of stormy developments in the legal profession in Germany, the pace of change has slowed down somewhat since the most pressing inadequacies have been removed. The two main accomplishments of the recent move for change are the legality of the multicity partnership and the liberalization of the rules on advertising.

Approximately a year ago, the legality of the multicity partnership²⁵ was still hotly debated, with different professional organizations taking different positions on the topic. Meanwhile, multicity partnerships have become a routine phenomenon in the profession. Almost all of the large corporate and international law firms have now realigned with a firm or firms in other German cities. At this point, it is difficult to imagine that the legislature would decide to turn the tide around and invalidate the multicity partnership.

Advertising by major German law firms has likewise changed over the last two or three years. Firm brochures, newsletters, and presentations used to be anathema, but now have become quite common. The unwritten rule remains that any advertising must be decent, primarily informative and not misleading, and that any aggressive advertising such as cold calls must be avoided. More lawyers are expected to focus on advertising and engage in individual and joint marketing efforts.²⁶

B. PRACTICE OF U.S. ATTORNEYS IN GERMANY

A 1990 amendment to the Federal Attorneys' Act²⁷ introduced new section 206, subsection 2, providing for the admission of non-EC lawyers to practice their home law in Germany if reciprocity between Germany and their home jurisdiction was ensured. This determination was to be left to a regulation to be promulgated by the Federal Ministry of Justice.

In a memorandum to the Justice Ministry published in early 1992, a committee of the Federal Attorneys' Chamber²⁸ stated that it considered reciprocity with respect to New York²⁹ as being ensured provided that the New York rules regarding the registration of foreign attorneys as legal consultants were changed in a number of points. In particular, the committee would require that foreign legal consultants be able to form partnerships with attorneys and that New York waive

25. Überörtliche Sozietät.

26. To name an example, a private entrepreneur has formed an "attorney location service" (Anwalt-Suchservice), which consists of a data base of attorneys marketed to potential clients. The Federal Constitutional Court has held that an attorney's participation in such a service is acceptable under German ethical rules (decree of Feb. 17, 1992, MDR 1992, 338.).

27. Bundesrechtsanwaltsordnung (BRAO).

28. EK-Ausschuss of the Bundesrechtsanwaltskammer, BRAK-Mitteilungen 1992, at 87.

29. The committee said that the same considerations applied with respect to Alaska, California, District of Columbia, Hawaii, Michigan, New Jersey, Ohio, Oregon, and Texas.