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Editors

**Key
Aspects
of German
Business
Law**

A Practical
Manual

Fourth Edition

 Springer

Key Aspects of German Business Law

Michael Wendler • Bernd Tremml
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Preface

This book presents a clear and precise overview of the key aspects of German business law. It was written by attorneys involved in the daily practice of business law in Germany and is aimed at people who wish to orient themselves quickly with the German legal system and the manner in which it impacts business purchases, establishment, operations and liquidations.

The first section of the book is devoted to an explanation of the major issues to be considered in acquiring or establishing a business in Germany. The second section focuses on areas of commercial law that are important for an operating business. In comparison to the last edition four new areas (transportation law, customs regulations, insurance law and state liability law) are treated. The following sections deal with labor law as an independent part of German business law and with computer law. Furthermore, procedural law and European law are addressed. Finally, the last two sections of the book are devoted to an overview over the German tax law, which has an enormous impact on business decisions, and IP law.

In all sections special attention has been paid to highlighting and explaining the differences between the German legal system and that of the United States. Nevertheless, the intention is to provide information that will prove valuable to all foreigners, particularly business men and women and lawyers advising clients with an interest in doing business in Germany.

Although it is the object of this book to provide readers with a general orientation and the foundation for making informed decisions concerning business transactions in Germany, it cannot possibly function as a substitute for case-specific professional advice and by no means purports to do so. Those readers who wish to follow up on any decisions they may have formed on the basis of the material presented here are well advised to seek the guidance of qualified attorneys and tax advisors before entering into any binding obligations.

This holds particularly true in light of the fact that all information here is based on the laws that were in effect in the Federal Republic of Germany on the first of January 2008.

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Munich, Germany
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Contents

Introduction	1
B. Tremml	
 Part I How to Establish or Acquire a Business in Germany	
 Recognized Forms of Business Organizations	7
B. Tremml and B. Buecker	
 Establishment of a Company or Branch Office	33
T. Fischl	
 The Acquisition of Closely Held Companies	39
B. Tremml	
 Valuation of Business Enterprises	55
B. Tremml	
 “Pseudo – Foreign Companies” in Germany – The Centros, Überseering and Inspire Art Decisions of the European Court of Justice	59
K.F. Sturmfels	
 Part II Commercial Law	
 The Law of Contracts	67
M. Lubber	
 General Terms of Business (AGB)	81
A. Stadler and M. Lubber	
 Torts	95
T. Tremml	

Product Liability Under German and European Law 107
R. Grote

Real-Estate Property Law Germany..... 117
C.R. Wolf

The Law of Insolvency and Security Interests 127
R. Nacke

Unfair Competition..... 139
H. Schroeder

The Law of Public Procurement..... 147
N. Müller

Distribution Agreements 163
M. Bihler

Private Public Partnerships 177
K.F. Sturmfels

Copyright..... 185
C. Gerlach

Review of German Private Insurance Law..... 201
T. Steffens

Transport Law and Forwarder Law 217
J. Walther

Customs Law 239
B. Kosny

Liability of the State..... 263
M. Luber

Part III Labor Law

Aspects of German Labor Law..... 277
W.D. Schenk

Residence and Work Permit..... 291
M. Wendler

Part IV Computer Law

Computer Law 307
M. Karger

Electronic Commerce 317
R.E. Walch

Protection of Internet Domain Names 323
W.C. Leonti and H. Schroeder

Part V Procedural Law

**Enforcement of Rights and Claims through the Courts
and Arbitration Tribunals**..... 331
R. Nacke

Principles of the Legal Regulation of Attorney Fees 339
S. Sandrock

Notaries in Germany..... 351
C.R. Wolf

Part VI European Law

Institutions of the European Community 365
B. Tremml

Antitrust Law in the European Community 377
B. Tremml and M. Luber

Part VII Tax Law

German Tax Law 389
I. Badura

Part VIII IP

The PCT and the Enforcement of Patents in Europe 407
K. Rupprecht

Trademark Protection in Germany and Europe..... 465
E. Popp

Glossary of German Terms and Abbreviations

Abgabenordnung (AO)	Tax Code
Abstraktionsprinzip	Abstraction Principle
Abtretung	Assignment
Allgemeine Geschäftsbedingungen (AGB)	General Terms of Business
Amtsblatt der Europäischen Union	Official Journal of the European Union
Amtsgericht	Court of Small Claims; Municipal Court
Änderungskündigung	A Termination of a Contract with the Reserved Right to Renew it Under Altered Conditions
Änderungsvertrag	Contract of Amendment
Angestellte	Employees; Salary Earners; “White Collar” Workers
Aktiengesellschaft (AG)	Stock Corporation
Aktiengesetz (AktG)	Corporation Act
Aktionär	Stockholder (of a Stock Corporation)
Aktie	A Share of Stock; Stock Certificate
Arbeiter	Laborers; “Blue Collar” Workers
Arbeitserlaubnis	Work Permit
Arbeitserlaubnisverordnung (AEVO)	Work Permit Regulations
Arbeitsförderungsgesetz (AFG)	Work Promotion Act
Arbeitsgerichtsgesetz (ArbGG)	Code of Labor Procedure
Arbeitslosenversicherung	Occupational Incapacity Insurance
Arrest	Freeze Order
Arzneimittelgesetz (ArzneimittelG)	Pharmaceutical Products Act
Aufenthaltserlaubnis	Temporary Residence Permit
Aufenthaltsgesetz	Federal Residence Act
Aufsichtsrat	Supervisory Board of a Company or Corporation
Ausländer	Foreigner; Alien

Ausländergesetz (AuslG)	Aliens Act
Ausländeramt	Aliens Office
Außenministerium	Department of Foreign Affairs
Außenwirtschaftsgesetz	Federal External Trade Act
Begehungsgefahr	Danger of Commission of an Offense
Bergamt	Mining Authorities
Berufsgenossenschaft	Administrative Authorities in Charge of Providing Social Insurance due to Occupational Accidents
Berufungsverfahren	Appellate Proceedings (to the Next Higher Court)
Beschäftigungsverordnung (BeschV)	Employment Regulation Order
Betriebsaufgabe	Abandonment of a Business Enterprise
Betriebsrat	Works Council
Betriebsstätte	Operational Location (Dependant Branch Office)
Betriebsverfassungsgesetz (BetrVG)	Employee Representation Law
Bezirk	District
BGB-Gesellschaft	See Gesellschaft Des Bürgerlichen Rechts
BGB-InfoV	Federal Ordinance on the Duty to Provide Information to the Consumer
Bilanz	Commercial Balance Sheet
Bilanzrichtliniengesetz	Accounting Directives Act
Bundesagentur für Arbeit	Federal Employment Office
Bundesarbeitsgericht	Federal Labor Court
Bundesministerium für Arbeit und Soziale Sicherung	Federal Department of Labor and Social Order
Bundesfinanzhof	Federal Finance Court
Bundesgerichtshof (BGH)	Federal Supreme Court
Bundeshaushaltsordnung	Federal Budget Code
Bundesimmissionsschutzgesetz (BImSchG)	Federal Emission Act
Bundeskartellamt	Federal Cartel Authority
Bundesrechtsanwaltsordnung (BRAO)	German Bar Act
Bundesrechtsanwaltsgebührenordnung (BRAGO)	Attorneys' Fee Ordinance
Bundespatentgericht	Federal Patent Court
Bürgerliches Gesetzbuch (BGB)	Civil Code
Bürge	Guarantor
Bürgschaft	Surety or Personal Guarantee
Bundesverfassungsgericht	Federal Constitutional Court

Darlehen	loan Intended for Consumption (Normally a Monetary Loan)
Delikt	Tort (Compensatory), Unlawful Act
Deutsche Angestelltengewerkschaft	White Collar Union
Deutscher Beamtenbund	Civil Servants' Union
Deutsche Bundesbank	Federal Reserve Bank of Germany
Deutscher Gewerkschaftsbund (DGB)	German Association of Industrial Labor Unions
Dienstvertrag	Contract for Services (Without any Promise of Specific Result, as Opposed to a Werkvertrag)
dinglicher Vertrag	Real Contract
dispositives Gesetzesrecht	Non-Mandatory Statutory Law
Duldung	Residence Toleration
Durchführungsverordnung zum Ausländergesetz (DVAuslG)	Implementation Ordinance of the Aliens Act
Einfuhrumsatzsteuer	Import Turnover Tax
Einführungsgesetz zum BGB (EGBGB)	Introductory Act to the Civil Code
Einigungsgebühr	Settlement Fee
Einkommenssteuer	Personal Income Tax
Einkommenssteuergesetz	Income Tax Act
einstweilige Verfügung	(Preventive) Injunction
Einzelunternehmen	Sole Proprietorship
Entscheidungen des Bundesgerichtshofs in Zivilsachen (BGHZ)	Decisions of the Federal Court for Civil Cases
Entsendung	Posting
Erbbaurecht	Inheritable Building Right
Erbrecht	Inheritance Law
Erbschaftssteuer	Inheritance and Gift Tax
Erfolgshonorar	Contingent Fee
Erstbegehungsfahr	Danger of First-time Commission of an Offense
Europäische Gesellschaft	Societas Europae (SE), European Stock Corporation
Europäisches Patentamt	European Patent Office
Europäische Wirtschaftliche Interessenvereinigung (EWIV)	Business for Multinational Enterprises Comparable to the General Partnership
Europäischer Gerichtshof (EuGH)	European Court of Justice (ECJ)
Europäische Gesellschaft	Societas Europae (SE), European Stock Corporation

Europäischer Wirtschaftsraum (EWR)	European Market
Fernabsatzgesetz	Act on Distant Sale Contracts
Fernstraßenbaufinanzierungsgesetz	Private Highway Construction Financing Act
Finanzamt	Tax Office; Tax Authorities
Firma	Legally: Corporate Name
Freizügigkeitsgesetz/EU	Freedom of Movement Act/EU
Gebührensatz	Rate of Charges/Fee Rate
Gebührenvereinbarung	Fee Agreement
Gefährdungshaftung	No-Fault Tort Liability
Gegenstandswert	Value of the Subject Matter
Gemeinde	Community or Municipality
Gentechnikgesetz (GenTG)	Genetic Technology Act
Geräte- und Produktsicherheitsgesetz (GPSG)	Equipment and Products Safety Act
Gerichtskostengesetz (GKG)	Court Costs Act
Gerichtsvollzieher	Sheriff's Officer (Official Debt Collector)
Gesamtbetriebsrat	Combined or Overall Works Council (Of More Than One Business Unit)
Gesamthandsvermögen	Joint Ownership (of the Property of a Partnership)
Geschäftsbesorgungsvertrag	Contract for Business Services
Geschäftsführung ohne Auftrag	Settlement of a Third Party's Legal Obligations Without a Contract
Geschäftsgebühr	Fee for Out-of-Court Work
Gesellschaft des bürgerlichen Rechts (GbR)	(Also: BGB-Gesellschaft) Civil-Law Partnership
Gesellschaft mit beschränkter Haftung (GmbH)	Limited Liability Company
Gesellschafter	Shareholder (In a Limited Liability Company)
Gesellschafterversammlung	Shareholder Meeting (Limited Liability Company)
Gesellschaftsvertrag	Articles of Incorporation Gesetz Law or Act
Gesetz gegen Werbung auf dem Gebiet des Heilwesens	Law Against Advertising in the Health-Care Sector
Gesetz gegen den unlauteren Wettbewerb (UWG)	Unfair Competition Act
Gesetz gegen Wettbewerbsbeschrän- kungen (GWB)	Act Prohibiting Restrictions of Competition

Gesetz über den Vertrieb ausländischer Investmentanteile (AuslInvestmG)	Law on Foreign Investment Shares
Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen (AGBG)	Law for the Regulation of General Business Terms
Gewerbeaufsichtsamt/Gewerbeamt	Trade Supervision Office
Gewerbeordnung (GewO)	Trade Supervision Law
Gewerbesteuer	Trade Tax
Gläubiger	Creditor
Gläubigerversammlung	Creditor's Meeting (In an Insolvency Proceeding)
Gläubigerverzug	Delay of the Creditor
GmbH & Co KG	Business Organizational Form Which is a Combination of a Limited Liability Company and a Limited Partnership
GmbH-Gesetz (GmbHG)	GmbH Act (Law Governing Limited Liability Companies)
Gründungstheorie	Incorporation Theory (of Business Enterprises)
Grundbuch	Land Register at the Local Court
Gründerwerbssteuer	Real Estate Transfer Tax
Grundpfandrecht	Real-Estate Mortgages
Grundsätze ordnungsgemäßer Buchführung	Principles of Proper Accounting
Grundsteuer	Real Estate/Property Tax
Haftpflichtgesetz (HaftpflG)	Liability Act
Haftungsausschluss	Total Exemption from Liability
Haftungsbeschränkung	Limitation of Liability
Handelsgesetzbuch (HGB)	Commercial Code
Handelsgewerbe	Commercial Trade Enterprise (Owned and Operated by Individuals Who are Merchants by Profession). Governed by the HGB
Handelsregister	Commercial Register
Handlungsvollmacht (see also: Prokura)	Full Power of Attorney (to Represent an Enterprise)
Handwerksordnung	Handicrafts Code
Hauptfürsorgestelle	Head Office for Public Assistance
Hauptniederlassung	Company Headquarters, Main or Head Office
Hauptversammlung	Stockholder Meeting (Stock Corporation)

Industriegewerkschaft (IG)	Industrial Trade Union
Industrie- und Handelskammer (IHK)	Chamber of Industry and Commerce
Informations- und Kommunikationsdienstengesetz (IuKDG)	Federal Information and Communication Service Act
Inhaberaktie	Bearer Stock Certificate
Insolvenzordnung	Federal Insolvency Act
Insolvenzplan	Insolvency Plan
Insolvenzverwalter	Insolvency Administrator
Interessenausgleich	Compromise on Issues of Disagreement Involving Conflicting Interests (for Example, of Employers and Employees)
Investmentgesetz	Investment Act
Kapitalerhaltungsregeln	Rules on Capital Maintenance
Kapitalertragssteuer	Capital-Yield/Withholding Tax
Kapitalspiegelmethode	Literally: Capital-Mirroring Method. the Reflection of the Actual Net Value of a Partnership in its Fiscal Balance (As Opposed to Using the Purchase Price as the Means of Measure)
Kaufmann	Merchant
Kausalitätsvermutung	Assumption of Causation in Regard to Tort Liability
Kommanditgesellschaft (KG)	Limited Partnership (for Merchants)
Kommanditgesellschaft auf Aktien (KGaA)	Limited Partnership Combined with Stock
Kommanditist	Limited Partner (in a Kommanditgesellschaft)
Komplementär	General Partner; Personally Liable Partner (in a Kommanditgesellschaft)
Konkurs	Bankruptcy
Konkursordnung (KO)	Bankruptcy Act
Kontrahierungszwang	Obligation to Enter into Contracts
Kostenordnung (KostO)	Cost Regulation (for Notary Fees)
Kostenrechtsmodernisierungsgesetz (KostRMoG)	Legal Costs Modification Act
Körperschaftsteuer	Corporate Income Tax
Krankenversicherung	Private Health Care Insurance
Kreditwesengesetz (KWG)	Lending Business Act
Kündigungsschutzgesetz (KSchG)	Termination Protection Act
Ladenschlussgesetz	Store Closing Hours Act
Laienrichter	Lay Judges
Landgericht	Regional Court
Landkreis	County (Approx. Equivalent)

Leasingvertrag	Leasing Contract
Lebensmittel- und Bedarfsgegenständegesetz	Food and Essential Commodities Law
Leihe	Gratuitous Loan
Leitende Angestellte	Senior Executives; Managerial Employees (with the Ability to Hire and Fire); Literally: Leading Employees
Lohnsteuer	Wage Tax
Mahnverfahren	Summary Proceeding for Debt Collection
Markengesetz	Trademark Act
Mehrwertsteuer	(MwSt) (also: Umsatzsteuer) Value- Added Tax (VAT)
Mehrwertsteuergesetz (MwStG)	Value-Added Tax Act
Minderkaufmann	Miete Rent Small Merchant
Mitbestimmungsgesetz (MitbestG)	Co-Determination Law Enabling Employee Representation in a Company's Management
Montan-Mitbestimmungsgesetz	Coal-and-Steel Co-Determination Law
Mutterschutzgesetz (MuSchG)	Maternity Protection Act
Namensaktie	Registered Stock
Niederlassung	Branch Office
Niederlassungserlaubnis	Permanent Settlement Permit
Niederlassungsfreiheit	Right of Establishment Of Companies
Nießbrauch	Usufruct
Notar	Notary
Oberfinanzdirektion	Superior Finance Directorate
Oberlandesgericht	Court of Appeals
Offene Handelsgesellschaft (OHG)	General Partnership (for Merchants)
ÖPP-Beschleunigungsgesetz	Private–Public-Partnerships Acceleration Act
Pacht	Leasing (of an Establishment or a Real Property)
Patentanwalt	Patent Attorney
Pariser Verbandsübereinkunft	Paris Convention
Partnerschaftsgesellschaft	Professional Partnership
Personengesellschaft	Partnership
Pflegeversicherung	Long-Term Care Insurance
Preisangabenverordnung (PAngV)	Price Indication Regulation
Produkthaftungsgesetz	Product Liability Act
Prokura	Full Power of Attorney Enabling Company Representation by an Employee
Rahmengebühr	Lump-Sum Fee with an Upper and Lower Limit

Recht der Leistungsstörungen	Law of Irregularities in Performance
Rechtsanwalt	Attorney at Law
Rechtsanwaltsvergütungsgesetz (RVG)	Attorney Remuneration Act
Rechtspersönlichkeit	Legal Personality or Nature (of a Business Venture)
Regierungspräsident	President of the Regional Administration
Rentenversicherung	Retirement Pension Insurance
Repräsentanz	Representative Organization
Restschuldbefreiung	Discharge of Remaining Debt (in an Insolvency Proceeding)
Revisionsverfahren	Appellate Proceedings (to the Highest Court for Judicial Grounds)
Richterrecht	Judicial Law
Sachverständiger	Public-Appointed Experts
Satzung	Articles of Incorporation of a Stock Corporation
Schachtelbeteiligung	Intercorporate Participation; Mutual Stockholding
Scheinauslandsgesellschaft	Pseudo-Foreign Company
Schuldner	Debtor
Schuldnerverzug	Delay of the Debtor
Selbstbelieferung	The Ability to Procure Goods Oneself
SE-VO	European Stock Corporation (SE) Implementation Regulation (VO)
Sitztheorie	Real Seat Theory (of Business Enterprises)
Solidaritätszuschlag	Solidarity Contribution/Surcharge
Sozialgesetzbuch (SGB)	Federal Public Welfare Act
Sozialversicherung	Social Insurance
Sozialversicherungspflicht	Compulsory Social Insurance
Stammaktie	Common Stock
Stammkapital	Nominal Capital of a Business Enterprise
Steuer	Tax
Steuerberater	Tax Advisor
Stille Gesellschaft	Silent or Dormant Partnership
Stuttgarter Verfahren	Stuttgart Procedure (a Way of Assessing the Value of a Business, which was Once the Standard Procedure in Germany but has Recently Fallen Out of Use Due to its Inaccuracy Pitfalls)
Terminsgebühr	Appointment Fee
Überschuldung	Excessive Indebtedness

Umsatzsteuer	Value-Added Tax (Vat). Literally: Sales Tax
Umwandlung	Transformation of a Business Enterprise from One Organizational form to Another
Umwelthaftungsgesetz (UmweltHG)	Environmental Liability Act
Unbedenklichkeitsbescheinigung	Clearance Certificate
unerlaubte Bereicherung	Undue Benefit
unerlaubte Handlung	Unlawful Conduct
Unfallversicherung	Accident Insurance
Unterlassungsklagengesetz	Law Enabling the Filing of Suits for Discontinuance of Using Unlawful General Terms of Business
Urhebergesetz (UrhG)	Copyright Act
vereidigter Buchprüfer	Certified Bookkeeper
Verfahrensgebühr	Litigation Fee
Verfassung	Constitution
Vergabeverordnung (VgV)	Regulation on the Award of Public Contracts
Vergütungsverzeichnis (VV)	Catalogue of Fees for Legal Services
Vermögenssteuer	Wealth tax
Vermögensübertragung	Transfer of Corporate Assets and Liabilities Into Public Ownership
Verschmelzung	Corporate Merger
Verschmelzung durch Aufnahme	Take Over; A Merger with at Least One Other Company
Verschmelzung durch Neubildung	Consolidation of One Corporation with Another for the Purpose of Forming an Entirely New Corporation
Versicherungsaufsichtsgesetz (VAG)	Insurance Supervision Act
Versicherungsvertragsgesetz	Insurance Act
Vertrags- und Vergabeordnung für Bauleistungen (VOB)	Regulation for Standard Terms for Contracting Construction Work
Verwaltungssitz eines Unternehmens	Principle Place of Business
Vorschuß	Retainer
Vorstand	Board of Management
Vorzugsaktien	Preferred Stock
Wasserhaushaltsgesetz (WHG)	Water Conservation Act
Werkvertrag	Contract for Work and Labor Promising A Specific Result
Wertgebühr	Fee Based on Case Value
Wettbewerbshandlung	Competitive Act
Wettbewerbsrecht	Law on Competition
Widerrufsrecht	Revocation Right

Wiederholungsgefahr
Wirtschaftsprüfer
Wohnungseigentum
Zivilprozessordnung (ZPO)
Zug-um-Zug-Leistung
Zwangsvertrag
Zweigniederlassung

Danger of Repetition of an Offense
Certified Public Accountant (CPA)
Condominium
Code of Civil Procedure
Mutual Simultaneous Performance
Compulsory Contract
Independent Branch Office

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Introduction

Overview of the German Legal System and its Role in Light of Germany's Membership in the European Union

B. Tremml

Foreigners interested in starting a business or investing in German companies are generally attracted by the prospect of expanding into other European markets. Germany's membership in the European Union (EU) is a beneficial factor when deciding whether to invest in Germany, especially, because of the recent broadening of the EU. On 21 December 2007, nine new countries (Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia and Slovakia and the Czech Republic) joined Europe's travel zone, the Schengen area. This means there will be no more border checks on people travelling between these and other Schengen countries by land or sea, and checks at airports are set to end in March 2008. In addition, travelers from outside the EU need just one visa to travel to all Schengen states. In addition, the new EU treaty (the so called Lisbon treaty) that was signed on 13 December 2007 and is expected to be in force by the next European elections in June 2009, improves the decision making in the EU and, therefore, contributes to the complete establishing of a common market.

However, there also have been concerns about the implications of the dual European and German legal systems. Investors may wonder whether a German venture requires familiarization with two, often-conflicting bodies of law, or if businesses in Germany frequently have to deal with administrative authorities at both the national and international level with regard to the same transaction. The answer to such questions is "no." Given the structure of the EU and particularly the manner in which EU institutions pass laws, an investment in Germany does not place investors in a legal quagmire. Nevertheless, there are some legal areas where European law is directly applicable, for example, in antitrust law.

As a fundamental principal, the EU and its institutions possess the power to pass legislation in only those areas in which an express delegation of national authority exists. For this reason alone, many regulatory areas remain outside of the EU's control. For example, most civil, criminal, and administrative laws remain the sole province of the Member States. In general, the EU's authority is limited to those regulatory areas which are essential to the establishment of a common market. Furthermore, the laws that have been passed by the EU tended to take the form of "directives." As will be explained in detail in the chapter entitled "Institutions of the EU", directives do not, as a general principal, take effect until after they have been incorporated into national law. This special characteristic of directives is intended

to give Member States the flexibility of choosing the manner in which a directive becomes law in their own country. Accordingly, Member States can choose a directive that is most compatible with their particular legal system. For individuals and business enterprises alike, it is often not easy to recognize whether or not a national law is based on a European directive. In summary EU directives do *not* constitute an overlay of regulations which investors must familiarize themselves with, but rather comprise an integral part of a Member State's national law.

However, that is not to say, that the EU's influence should be downplayed. The numerous areas of law impacting the establishment and operation of businesses in Germany are often reflective of EU law. Nevertheless, for the most part EU laws have been incorporated into national law and are subject to Germany's legal system. It is within this system that foreign investors will predominantly conduct their business transactions.

For the most part, Germany's legal system is stable and smooth working. It is based on the Continental European legal tradition as opposed to Anglo-Saxon law upon which the U.S. legal system is based. The primary difference between the two systems is that the Continental European legal system is based on "code law" as opposed to "case law." In accordance with the Continental tradition, the German legal system consists essentially of written laws. Nearly all potential regulatory areas are the subject of formal and detailed codification. Many of Germany's legal codes are the final product of decades of careful deliberation and refinement. This offers foreign entrepreneurs and investors considerable advantages. German law is so clearly structured and transparent that contract terms can be standardized to a very large extent. All the standard practices and regulations governing a business's conduct are codified in the German Civil Code (BGB, or "Bürgerliches Gesetzbuch"). Therefore, if no special terms are agreed upon between the parties, the terms and provisions of the BGB automatically apply. In other words, in the U.S., business contracts require the clear and detailed statement of all the terms the parties agree to. Contracts in Germany tend to be considerably shorter, which lowers their drafting costs accordingly.

German law has undergone numerous reforms in recent years, which, for the most part, have had a very positive impact on business activities, even though there have been some less favorable developments. The Commercial Code was liberalized by broadening the definition of "merchant", thus, making it easier for people to get started in business. Additionally, the Handcrafts Code ("Handwerksordnung") was modified to make it easier to demonstrate professional qualification. Business activities in the domestic market were also facilitated through a considerable loosening of the laws regulating unfair trade.

On the other hand, disadvantageous are the new regulations in contract and civil process law. Contract law now ensures an extraordinary high degree of consumer protection at the expense of merchants. Furthermore, the extent and complexity of the reforms have led to a certain degree of legal confusion. The changes made in civil process law make it more difficult to acquire access to appellate courts, which very often necessitates cost-and-effort intensive proceedings right from the start.

As in the U.S., it is the task of the courts to interpret the written law. Because a number of German codes are more than a hundred years old, the case law pertaining

to certain individual provisions of them is very extensive. The courts have the primary task of interpreting the statutes, regulations, and Constitution, and they also play a role in filling in the gaps of laws where necessary. However, the reliance on precedence plays a much smaller role in the German legal system than in American jurisprudence, since German laws are explicitly detailed and codified.

The sharp differentiation between the various areas of law in Germany and the separate codification of them have led to a strict division of subject-matter jurisdiction among the different types of courts. As in the U.S., there are separate civil courts responsible for deciding legal disputes among private persons, and there are criminal courts for criminal prosecutions brought by the State against individuals. In contrast to the U.S. legal system, there are also separate court systems for administrative matters or legal disputes involving measures taken by public authorities against residents and for labor-law and financial matters. Germany has a special body of law governing taxation and a court system specialized in trying tax cases as well. It should also be noted that, in contrast to the U.S. judicial system, there is no duality between state and federal courts. In Germany, their areas of jurisdiction are clearly kept separate. Each of the various court systems has its own supreme court. The Constitutional Court is the final authority.

The judges who serve on the courts are judges by profession and are specialized in one type of law. They do not rotate from one type of court to another as U.S. judges do, but generally serve on only one type of court throughout their careers. They are not elected but rather appointed by the government of the particular state of Germany where the court is located. Germany does not make use of the jury process. However, in certain cases the judges are assisted in making their decisions by common citizens who do not necessarily have a legal background of any kind (“Laienrichter/lay judge”) and who are chosen to serve on the court for a limited time period.

Regardless of which type of court is handling a particular dispute, the parties’ trial preparation consists primarily in the drafting and presentation of legal briefs in which evidence is presented and the issues in dispute are argued. In doing so, the parties rely on the court’s special procedural rules. Each type of court has its own rules, such as determining case procedure, the kind of evidence it will admit, etc. The courts make extensive use of independent public-appointed experts (“Sachverständiger”), whose professional input almost always influences the ruling to a very large extent and often determines the outcome of a case. Due in part to the judicial system’s reliance on the parties’ briefs, the reports of independent experts and other written submissions, the trial itself (in particular the in-court presentation of live testimony and other evidence) takes considerably less time and involves less costs than U.S. court proceedings. This will be discussed extensively in chapter “Enforcement of Rights and Claims”. With the exception of criminal cases, most trials last no longer than one or two days.

An overview of Germany’s legal system would not be complete without a few comments about the governmental administrative apparatus. The Federal Republic of Germany is, as its name expresses, a federal state. That means that legislative powers are divided between the federal government and each of the country’s states.

The most important areas of law are the exclusive domain of the federal government. However, because individual states of Germany are generally vested with the authority to enforce federal laws and the majority of the administrative offices necessary to accomplish this task are established by the states, the states have an important influence on the interpretation and development of federal laws. Similar to the state subdivisions in the U.S., the states of Germany are comprised of districts (“Bezirke”), counties (“Landkreise”) and communities (“Gemeinde”). A striking difference between the two administrative systems is in many cases the higher degree of authority and competence exercised by the more local and regional units in Germany, which often allows them to take action and make decisions affecting both residents and businesses more efficiently and quickly.

In conclusion, it can be said that the legal system in Germany is precisely structured. Its areas of court jurisdiction are clearly defined and its laws so explicitly codified that overlapping and ambiguities are largely ruled out. This makes it relatively easy for foreigners to orient themselves within the system. They will find the drafting of business contracts to be a relatively swift and inexpensive process as opposed to the process in the U.S., where effort and costs generally tend to be considerably higher, because its laws allow a vastly wider degree of interpretation and all the terms of agreement must be contained in the contract itself. In contrast, the terms of the German Civil Code (BGB) regulating contracts automatically come into effect in the absence of other terms. Contracts between business partners are necessary only if the parties wish to agree to terms that differ from the standard provisions of the BGB. When looking at business operations, the clearly structured German system encourages fair, free trade and the minimization of conflicts.

Part I
How to Establish or Acquire a
Business in Germany

Recognized Forms of Business Organizations

B. Tremml and B. Buecker

1 Overview of Business Forms Available

The Federal Republic of Germany recognizes a variety of business organizational forms. Each of them has its own particular justification for existence based on specific economic considerations. It is therefore important for foreign business people who intend to establish a company in Germany to evaluate the various business forms available – for instance, in terms of their organizational structure, liability and methods of taxation – and determine which of them is most suitable for the enterprise they have in mind.

German law basically differentiates between business organizational forms which have the characteristic of a partnership (*Personengesellschaft* is the general term for partnership) and those which have the characteristics of a corporation. In contrast to partnership forms, the corporate ones each possess the status of a separate legal entity. Another major distinction is that, as a general rule, the shareholders of businesses organized as corporations possess limited liability equal to the amount of capital they have invested in the business, whereas a partnership's creditors can lay claim to the personal assets of each of the partners if necessary.

The corporate forms are:

- The GmbH, which is an abbreviation for *Gesellschaft mit beschränkter Haftung* and means limited liability company
- The AG, which is an abbreviation for *Aktiengesellschaft* and means stock corporation
- The SE, which is an abbreviation for *Europäische Gesellschaft* and is more or less equivalent to a stock corporation with a European significance

The partnership forms are:

- The GbR, which is an abbreviation for *Gesellschaft des bürgerlichen Rechts* and possesses some characteristics of a joint venture and some of a general partnership
- The OHG, which is an abbreviation for *Offene Handelsgesellschaft* and possesses characteristics of a general partnership

- The KG, which is an abbreviation for *Kommanditgesellschaft* and possesses characteristics of a limited partnership
- The *Einzelunternehmen*, or sole proprietorship
- The *Stille Gesellschaft*, or silent partnership
- The *Partnerschaft*, which possesses characteristics of a general and a limited partnership
- The *Europäische Wirtschaftliche Interessenvereinigung*, EWIV, a business form for multinational enterprises, comparable to the general partnership

In addition, Germany recognizes two types of business organizational forms which are a mixture of the corporate and partnership forms:

- The GmbH & Co. KG
- The KGaA, which is an abbreviation for *Kommanditgesellschaft auf Aktien* and is a type of limited partnership combined with stock

The most common business form used in Germany today is the GmbH (limited liability company). This is due to the fact that a GmbH is relatively easy to establish and operate and is an appropriate organizational form for almost all types of business. There are a comparatively smaller number of stock corporations in Germany, since this form is more suitable for very large enterprises such as banks and insurance companies; nonetheless, during the boom of the so-called “New Economy” numerous smaller companies jumped on the bandwagon and entered the stock market by changing their legal form. The partnership forms are less often found among larger enterprises because their owners or participants want to avoid being personally and fully liable for all of the debts of the business.

2 Corporate Forms of Business Organizations

2.1 Limited Liability Company [*Gesellschaft mit beschränkter Haftung (GmbH)*]

2.1.1 Nature

The legal basis for the limited liability company (GmbH) is contained in the GmbH Act (GmbHG), first adopted in 1898 and substantially revised in 1980. As an incorporated business entity, the GmbH itself possesses rights and obligations and is liable for all of its debts to the full extent of its corporate assets. It also may pursue and defend legal actions in its own name (Section 13 GmbHG).

In the GmbH’s articles of incorporation (*Gesellschaftsvertrag*), the shareholders set the amount of nominal capital which is to be paid into the corporation by each of them. In principle, the individual shareholders are then liable for the company’s obligations only in the amount of their committed capital investment. The GmbH cannot enforce an obligation against any shareholder in excess of that amount. Under German law, the shares of a GmbH cannot be quoted on stock exchanges.

The articles of incorporation can make special regulations for the individual needs and requirements of the company and its owners to the extent they do not conflict with the provisions of the GmbH Act.

2.1.2 Regular Formation Procedure

A GmbH can be established for any lawful purpose by one or more people. Its founder(s), or initial shareholders, may be natural persons or legal entities, residents or non-residents, German or foreign citizens. The law does not limit the number of shareholders who may participate in a GmbH.

The structure and operations of a GmbH are governed by its articles of incorporation. The first step in the process of forming a GmbH is the drafting of its articles by its founders (shareholders). The articles must be signed by each of the shareholders and approved by a notary. In addition to a statement of the name, location and purpose of the company, the articles must state the total amount of the nominal capital (*Stammkapital*) and the percent or share of it that each shareholder has agreed to pay in return for shares in the business. The name chosen for the company must directly relate to the company's purpose or contain the names of at least one of the shareholders. It is further required that the company name contain the designation "GmbH" ["company with limited liability" (see Section 4 GmbHG)].

The company comes into actual existence and is able to reap the benefits of having its liabilities limited to its assets only after it has been registered in the commercial register (*Handelsregister*) located in the district court of the company's place of business. Before that time, the founding partners are personally liable for their own business transactions during the GmbH's "formation stage" (Section 11 GmbHG).

Entry into the commercial register requires the submission of a formal application by the managing director(s) with all the necessary attachments, including:

- The articles of incorporation
- Original documents expressing the authority of any person to act on behalf of the founding shareholders (power of attorney) or a certified copy of the same
- A confirmation of the appointment of the managing director(s) if the appointment(s) are not stated in the articles of incorporation
- Specimen signatures of the managing director(s)
- A statement as to whether the managing director(s) are personally empowered to represent the company or whether they can do so only in conjunction with others
- A list of the shareholders, including their full name, profession and address as well as the share amount of the nominal capital investment guaranteed by each of them
- The assurance that the combined amount of cash and non-cash assets required by law before the GmbH can be legally registered has indeed been paid into the company and is available for use by its management. (The law requires that at least 25% of each share and 50% of the nominal capital must be paid-in before

the company can be registered unless non-cash investments have been arranged and agreed upon)

- In the case of a one-person GmbH the cash and non-cash contained in the company must equal € 25,000 – [twenty-five thousand euros] at the time of registration.
- Assurance that the total amount of investment shares (the nominal capital of the business, or *Stammkapital*) equals at least € 25,000.
- A special non-cash investment report verifying the actual value of any non-cash investments

According to the Act on Electronic Commercial Registers, Registers of Cooperatives and Business Registers (Gesetz über elektronische Handelsregister und Genossenschaftsregister sowie das Unternehmensregister), in force since 2007, the formation documents may be submitted electronically to the court of jurisdiction over the registration.

If all of the above requirements are met, the GmbH will be registered and the registration automatically announced in a nation-wide publication.

2.1.3 Capital Structure

Share Capital

The 1980 reform of the GmbH Act raised the statutory minimum amount of capital that must be invested by the owners in return for shares to € 25,000 – and the minimum that each single shareholder must invest to € 100.

The capital may be paid in cash, in kind (non-cash investments) or in a combination of the two. When a non-cash investment has been agreed to, a special report has to be presented so that the actual worth of the non-cash capital investments can be evaluated by the registry court.

It is not required that the nominal capital (upwards of € 25,000) be divided into equal amounts. Each share can be ascribed a value equal to the investment the individual shareholder has agreed to make and must be stated in the articles of incorporation. Shares can be subsequently split into units of less value and transferred to others, however, only with the approval of the company (Section 17 GmbHG).

Transfer of Shares

The shares of a GmbH are freely transferable and inheritable (Section 15 GmbHG). However, the articles of incorporation can stipulate that the transfer is conditional upon the consent of the GmbH or the other shareholders. A change of shareholders does not affect the continuity of the company. The company can acquire its own shares only if the share capital is fully paid-up, sufficient funds beyond the stated share capital exist, and the statutory reserves for its own shares can be maintained. In order to be valid, the transfer of a share (in whole or in part) must be notarized.

Increase and Reduction of Nominal Capital

The shareholders can increase or reduce the nominal capital figure as cited in the articles of incorporation, however, only in so far as they do not reduce it below the legally required minimum of € 25,000. The decision to raise or lower the capital value of a company requires a vote of three-fourths of the shareholder votes cast unless the articles of incorporation provide otherwise. The amendment to the articles of incorporation must be filed with the court so that the corresponding changes can be made in the commercial register (Section 54 GmbHG).

In the event that the nominal capital amount is to be increased, each of the shareholders must present a notarized statement that they are willing to raise their personal investments proportionate to the overall increase and according to the new value of their shares (Section 55 GmbHG). Moreover, new shareholders may be added to the GmbH at the time of an increase in the GmbH's nominal capital value.

In order that a reduction in the nominal amount of share capital take effect, the shareholder resolution authorizing it must be announced in the public journals officially responsible for publishing commercial-register matters. Any creditors who oppose the reduction are entitled to have their outstanding claims satisfied. The law proscribes that 1 year must have elapsed after the final public announcement before the GmbH can file an application to have the decreased capital amount officially noted in the commercial register (Section 58 GmbHG).

2.1.4 Representation and Management

Representation and management of a GmbH result from the cooperation of the following official corporate bodies: managing director(s), shareholders and supervisory board.

Managing Director (Geschäftsführer)

Because the managing director is the only person entitled to represent the company in and out of court (Section 35 GmbHG), the GmbH must – either in the articles of incorporation or by separate resolution – appoint one or more managing director(s) in order for the company to be able to act. The managing director must be a natural person with unlimited capacity to enter into legal transactions (Section 6 GmbHG) and may but need not be a shareholder of the company.

German corporate law differentiates between the external authority of the managing director and his or her internal rights and obligations. This means that, although the authority of the managing director may be and often is restricted by the provisions of the articles of incorporation, shareholder resolutions or the managing director's employment contract, such restrictions are of no effect concerning the managing director's interactions with third parties.

The managing director of a GmbH has the legal obligation to perform his or her duties with the "diligence of a prudent businessperson." And even though the

business transactions of the managing director(s) are valid with respect to third parties, if the directors violate their obligations to perform their duties carefully, they are jointly and severally liable to the company for any resulting damage. Under the general provisions of German tort law, the managing director's personal liability for wrongful acts committed against third persons is limited to situations in which he or she has personally acted.

The other situations in which the managing director can be held personally liable to third parties are:

- (1) If in the registration of a newly formed company the managing director has officially stated that one-fourth (or more) of the share capital has been paid by the shareholders and this is not the case (Section 64 GmbHG) or
- (2) The managing director fails to declare bankruptcy within 3 weeks after he or she has learned or could have learned that the company is either unable to pay its debts and/or that its liabilities exceed its assets

If the managing director has been appointed by a shareholder resolution, the appointment can be withdrawn by a new resolution. If the managing director has been appointed in the articles of incorporation, then, based on the rule that every change of the articles requires a 75% majority vote, he or she can be removed only by a three-quarters vote of the voting shareholders. Entry into the commercial register is necessary for all changes affecting the identity or representation authority of the managing director(s) (Section 39 GmbHG).

Shareholders (Gesellschafter)

The rights of the shareholders within the corporation, particularly with respect to the management of the business, derive from the articles of incorporation in so far as they are consistent with statutory provisions (Section 45 GmbHG). All shareholder resolutions must be adopted in a general meeting. Unless otherwise provided in the articles of incorporation, the managing director calls the shareholder meetings by sending registered letters to the shareholders at least 1 week in advance of the meeting. In their meetings, the shareholders are entitled to reach decisions which concern and impact the day-to-day operations of the business and to exercise complete discretion in issuing management instructions. There are particular issues which can be resolved only in a shareholder meeting. They include the appointment and dismissal of management, the granting and cancellation of *Prokuras* (full powers of attorney as defined in Section 48 HGB, the Commercial Code), the institution of claims for damages against the managing director or shareholders, the approval of financial statements and the agreement to the manner in which any dividends are to be distributed.

In order to be effective, shareholder decisions require a majority approval of those shareholders who participated in the vote (Section 47 GmbHG). Proxy voting is allowed. If all company shares are controlled by one shareholder, that shareholder must prepare and sign minutes without undue delay following the passage of a resolution.

Shareholders have the right, upon request, to be informed of business affairs by the company's management and to inspect the company books and records (Section

51a GmbHG). If management believes, however, that providing specific information could substantially impair business operations or otherwise be detrimental to the company, it can refuse the request. Any shareholder who has not been given the requested information or permission to inspect the books is entitled to file a court action seeking judicial resolution of the conflict.

Supervisory Board (Aufsichtsrat)

German law does not always require that a GmbH has a supervisory board. Any decision to establish such a board, however, must be reflected in the articles of incorporation. A GmbH must have a supervisory board if it is a capital-investment company. There are also cases in which the “Co-Determination Law” (*Mitbestimmungsgesetz*) makes such a board mandatory. This law, which requires that certain companies allow employee participation in management, will be described in more detail later. The supervisory board must consist of an equal number of shareholder and labor representatives and a neutral person. The neutral person may but need not be the chairman of the board.

Under the German Co-Determination Law, GmbHs with more than 2,000 employees must have a supervisory board consisting of an equal number of shareholder and labor representatives.

Section 1 (1) of the *Drittelbeteiligungsgesetz* requires that GmbHs with more than five hundred employees install a supervisory board comprised of a two-third majority of shareholder-elected members and a one-third minority of employee-elected members.

Whether a supervisory board has been created at the discretion of the shareholders or is required by law, its primary role is to represent the GmbH when dealing with the managing director(s) and to control the actions of the managing directors.

2.1.5 Accounting and Auditing

The managing director is responsible for ensuring that the GmbH has proper account books and balance sheets. Accounting and auditing laws pertaining to GmbHs are contained in the Commercial Code (HGB), the GmbH Act (GmbHG) and the tax laws.

In accordance with sound accounting principles, the company must keep proper account books showing all transactions, assets and liabilities. At the date of the GmbH's formation and at the end of each financial year, an inventory and a balance sheet must be prepared. These financial records must be kept for 10 years; commercial correspondence and invoices must be kept for 6 years.

In terms of the exact type of accounting requirements, German law differentiates between small, medium and large companies. Which of these size categories a company falls into depends on its profit, sales and number of employees. If the company is a so-called “large company,” its accounts must be audited by a certified public accountant (*Wirtschaftsprüfer*), and its annual financial statement, its management

report as well as the proposals and decisions on the distribution of profits must be made public according to the Accounting Directives Act. Mid-sized companies, on the other hand, may obtain the services of a certified public accountant (*vereidigter Buchprüfer*). There are no laws requiring audits in small companies.

2.1.6 Liquidation

Reasons for Dissolution

A GmbH can be dissolved at any time by a resolution passed by three-fourths of the shareholders participating in the vote, unless otherwise stipulated in the articles of incorporation. Furthermore, upon the application of shareholders holding at least 10% of the share capital, the company can be dissolved by court order. The issuance of such an order requires that the court finds either that it has become impossible for the GmbH to accomplish its purpose or that other substantial reasons stemming from the prevailing conditions in the company exist which are substantial enough to justify its dissolution.

Bankruptcy proceedings are another cause of the dissolution of a GmbH. If, however, the bankruptcy proceedings are terminated after the conclusion of a compulsory settlement or upon motion of a debtor, then the shareholders may elect not to dissolve the company.

Insolvency and Liquidation

When a GmbH becomes insolvent and the managing director has filed for bankruptcy, the court appoints a sequestor. When a GmbH is dissolved for a reason other than the initiation of bankruptcy proceedings, the managing director automatically assumes the role of sequestor. During the process of liquidation, the company must be clearly identified and recognizable as being in a state of liquidation.

The requestor's duties are to terminate current business, discharge all obligations of the dissolved company, collect its accounts receivable and convert all assets into cash. It is also his or her duty to prepare a balance sheet at the beginning of the liquidation process, once every year thereafter and at the conclusion of the process.

Except in the case of bankruptcy proceedings, the dissolution of the company must be registered in the commercial register, and a notice requesting creditors to file any claims must be published three times. The GmbH's assets may not be distributed to the shareholders until after the elapse of 1 year following the third publication. At this time (and assuming the liquidation process has otherwise reached the point where the assets can be distributed), all remaining assets are to be distributed among the shareholders in proportion to their shares. As mentioned above, all the books and records of a company must be retained for 10 years. Following a liquidation process, those documents are to be delivered to a former shareholder or third party for safe-keeping.

2.1.7 Expected Reform of 2008

The limited liability company with its simple formation procedure and structure is the most suitable legal form for foreign businesses wanting to limit the risks of their activities to the amount of capital they are willing to invest in Germany. Apart from that, there is possibly a thorough reform of the GmbH act in 2008. On May of 2007 the Federal Cabinet adopted the Government Bill for an Act to modernize the Law Governing limited liability companies and to combat abuses. The new law shall come into force in the first half of 2008; the exact time and content depends of the further legislation process. The main emphasis of the current draft of the new law lies on the acceleration and simplification of the establishment procedure and on the improvement of the limited liability company as a legal entity. If it comes into force, there will be several substantial changes:

The minimum nominal capital will be reduced from 25,000 to € 10,000. Moreover, there will be a special limited liability company for start-up businesses: the limited liability entrepreneurial company (see Section 5a GmbHG, haftungsbeschränkte Unternehmergesellschaft). This legal structure does not require a minimum nominal capital, but allows a full distribution of profits, but not before the minimum nominal capital required for a normal private limited company is reached.

As far as the formation procedure is concerned, the new law will provide for model articles of association. If these model articles are used, there will no longer be a need for a notarial deed certifying the articles of association. Nevertheless, a public authentication of the signatures is still necessary. Additionally, the new law will abandon the submission of a licence documentation to the court of registration, where a business purpose requires an approval pursuant to administrative law, for example, a commercial license.

Besides, it is very important that the new law enables an acquisition of shares in good faith. If the transferor is named in the shareholder list and no objection has been raised for at least 3 years, the acquirer may rely on the list, so that the transfer is not void, even if the transferor is actually not a shareholder of the company concerned.

Finally, the reform simplifies legal actions against companies. First, the business address can be found in the commercial register. Second, if a service of documents is impossible at this registered address, there will be a possibility of effecting a public service.

2.2 Stock Corporations [*Aktiengesellschaft (AG)*]

2.2.1 Nature

The formation and constitution of an AG are governed by legislation entitled the *Aktiengesetz* (AktG). Similar to the GmbH, an AG is an incorporated business entity with its own legal personality. Only its corporate assets are available to satisfy the

liability of the company to its creditors. The stockholders (*Aktionäre*) bear no personal liability.

The nominal capital (*Grundkapital*) of an AG is divided into stocks (*Aktien*) which, unlike the shares of a GmbH, may but need not be quoted on the stock exchange. The stocks are freely transferable, which makes the occupations and backgrounds of the individual stockholders completely irrelevant.

The stock corporation is the best business organizational form in Germany for large enterprises. It offers the best legal basis for an international business.

2.2.2 Formation and Registration

An AG can be formed by one or more persons who are willing to subscribe for stock in return for their capital investment. These persons may be individuals or corporate entities, residents of Germany or non-residents.

At the beginning of the formation procedure, the founders have to draft articles of incorporation (*Satzung*) which primarily must include: the AG's name, location, business objective and amount of stock capital (face amount as well as the number of stock certificates issued and their initial subscription price). The company's name usually reflects its activities and must be followed by the acronym "AG" In most cases, the designated seat of the corporation must be the place where the company intends to maintain an establishment, where its management is to be located or from where the administration of the company will be conducted.

The articles of incorporation must have been recorded by a German notary before the corporation can be officially formed and registered. The founders appoint the first supervisory board (*Aufsichtsrat*), which is then empowered to appoint the initial board of management (*Vorstand*). In addition to these two organs, the stockholders themselves, who are empowered to take action in general meetings called *Hauptversammlungen*, comprise the third organ of an AG. The members of the supervisory board and initial board of management are charged with examining the act of formation and rendering a written formation report. The formation must also be examined by one or more court-appointed formation auditors if one of the following circumstances exists

- A member of the board of management or the supervisory board is also one of the founders of the corporation
- A member of the board of management or supervisory board had stock earmarked for him- or herself, either directly or indirectly, during the formation stage
- A member of the board of management or the supervisory board will receive a special advantage
- The formation involves non-cash investments or related non-cash acquisitions

The AG must apply for registration in the commercial register (*Handelsregister*) of the local court responsible for the district in which the company is located. The application must be signed by all the founders as well as by each member of the board of management and the supervisory board. All underlying documents, including the articles of incorporation, must accompany the application for registration.

The registration will be granted only if the required percentage of the initial stock subscription has been duly paid-in. That amounts to at least 25% of the par value of the stocks in the case of cash subscriptions and 100% in the case of non-cash investments.

The AG comes into existence as a legal entity upon entry in the commercial register (Section 41 AktG). Until that time, anyone who acts on behalf of the corporation is personally liable.

2.2.3 Capital Structure

Stock Capital

The statutory minimum capital amount, which must be paid in full at the time of registration, is fifty thousand euros (€ 50,000). The capital is divided into par value shares, which can have a nominal value of at least € 1 and it has to be in full euro amount. The face value of the shares and their total amount must be expressed in euros.

Membership in an AG is documented by stock certificates. Both common stock (*Stammaktien*) and preferred stock (*Vorzugsaktien*) may be issued either as bearer stock certificates (*Inhaberaktien*) or as registered stock certificates (*Namensaktien*). In general, one share of stock entitles its owner to one vote on issues addressed in the stockholder meeting (*Hauptversammlung*). Preferred stock, however, may be stipulated as non-voting stock. Bearer stock is the most common type of stock issued by German stock corporations. The shares cannot be issued before they have been registered and the purchaser has paid the full issue price.

Transfer of Stockholdings

Bearer stock can be freely transferred and any attempt to limit that transferability is strictly prohibited. The transfer of registered stock, however, can be limited with the consent of the company, provided its articles of incorporation explicitly allow for such regulation in order to guarantee that the company maintains control and influence over its members and thus over its own operations.

In practice, bearer stock is usually offered by banks and the original certificates left deposited with them. The banks then collect the dividends on behalf of the investors. Stockholders who own a relatively small number of a corporation's total shares generally tend to give proxies to their banks to exercise their voting rights. Such proxies can be withdrawn at any time within that period (Section 135 AktG).

Increases and Decreases of Nominal Capital

An increase or decrease in the nominal capital amount requires a resolution passed by a three-fourth majority of the votes cast at a stockholder meeting.

An application for an increase or decrease must be filed with the commercial register. The new nominal capital amount becomes effective at the moment of registration.

The easiest way to increase the share capital is by issuing new shares against contributions, which may be in cash or non-cash. In the case of non-cash investments, the property, the name of the person from whom the AG acquires it and the nominal amount of the stock shares granted in return for it must be noted in the shareholder resolution to increase the company's nominal capital value on (Section 183 AktG).

Other ways to acquire new capital are through the issuance of convertible bonds, profit-sharing bonds or profit participating certificates.

Squeeze-Out

A so-called "squeeze-out" is an aggressive buy-out of minority stockholders (Section 327a ff. AktG). If the major stockholder holds at least 95% of the nominal capital, he can squeeze out the remaining co-shareholders against their will by buying them out in cash.

2.2.4 Representation and Management

Board of Management (Vorstand)

The board of management consists of one or more persons. The management board of a AG with a stock capital of more than three million German Marks generally must consist of at least two persons. In order to maintain the independence of both of the boards, a member of the board of management cannot serve as a member of the supervisory board and vice versa. The members of the board of management are usually appointed by the supervisory board for a period of 5 years.

The board of management is responsible for managing the business, handling all general administrative matters and representing the corporation in its dealing with third parties as well as in all judicial actions. The power of its authority may not be limited in its dealings with third parties. It is possible, however, to provide in the article of incorporation that certain actions require the approval of another organ of the AG.

The members of the board of management are each required to act with the diligence and care of a prudent and conscientious manager. Transactions entered into in violation of this standard of care, while valid and binding on the AG, make the members of the board of management personally liable to the corporation for any damage it has sustained as a result of their careless behavior. Board members cannot be held responsible for having breached their standard of care, however, if they have acted on a valid resolution of the stockholders.

Supervisory Board (Aufsichtsrat)

In contrast to the law governing the GmbH (GmbHG), the law pertaining to the AG (AktG) requires that every AG establish a supervisory board. This board's primary functions are the appointment and dismissal of board of management (Vorstand), supervision of executive management, approval of the financial statements prepared by the executive managers and approval of any special transactions enumerated in the articles of incorporation.

The size of the supervisory board may vary between three and twenty-one members, depending on the size of the corporation. In AGs which employ less than 2,000 people the size of the board depends on the nominal value, or share capital, of the company. If the value of share capital is three million German Marks or less, the law requires a board consisting of three but no more than nine members. If the capital value lies between three and twenty million German Marks, the law requires that between three and fifteen members be appointed. Corporations with a capital value of more than twenty million German Marks are required to appoint between three and twenty-one members.

German law gives employees of larger corporations the right to vote for a portion of the supervisory board and/or to serve on it through representation. The membership of employees on the supervisory board is generally dependent on the overall number of people employed by the corporation. Certain industries have special regulations governing employee participation.

Stockholder Meeting (Hauptversammlung)

The general meeting of the stockholders must be held annually and within 8 months after the end of the business year. The meeting must take place in Germany and generally at the place where the AG has its registered office. In addition to the general meeting, extraordinary stockholder meetings can be called by the supervisory board or by stockholders holding at least 5% of the common stock.

The stockholders, acting in concert at their general meeting, are responsible for the appointment and removal of their supervisory board representatives, the election of auditors, the formal approval of actions taken by the supervisory board and the board of management during the preceding business year and decisions concerning the distribution of profits. The most important of the statutory powers that are the exclusive rights of the stockholders are the rights to

- Amend the articles of incorporation
- Reduce or increase the stock capital
- Liquidate the AG

2.2.5 Accounting and Auditing

Legal requirements imposed on an AG's accounting system are primarily found in the Commercial Code (HGB, part two), the AktG and the tax laws. The second part of Commercial Code came into effect in 1986 through the Accounting Directives Act (*Bilanzrichtliniengesetz*), which was instituted in compliance with the European Community law stipulating that the Fourth, Seventh and Eighth EC Directives be incorporated into national law. The EC-IAS-Regulation, which came into effect on 9-11-2002, stipulates that companies such as stock corporations that are aimed at the capital market must do their accounting according to IAS/IFRS standards.

Books and records must be kept in accordance with the principles of proper accounting (*Grundsätze ordnungsgemäßer Buchführung*). These principles are derived from a variety of sources and are constantly being developed, expanded and interpreted. Requirements of the Commercial Code include:

- The maintenance of books and records in a modern language and the notation of currency figures in euros
- The preparation of annual financial reports
- The retention of account books, other financial records, invoices and correspondences for a certain prescribed period of time

The tax laws require that the AG's accounting system be maintained in such a way that an independent expert can obtain an overview of its assets, liabilities and business operations within a reasonably short time. The account records must be kept and archived in Germany. Usually the company's goods must be inventoried and the results of the inventory recorded in the balance sheet with validity as of the date on which the balance sheet is legally due.

Further requirements contained in the HGB as well as the AktG regarding the preparation and presentation of financial reports include:

- Maintenance and reflection in the balance sheet of a statutory reserve fund equal in amount to the value of at least 10% of the common stock
- Use of a prescribed format for the balance sheet and income statement
- Compliance with certain rules pertaining to the valuation of assets, liabilities, and stockholder equities; for example, the whole share capital must be stated at par value and liabilities must be indicated in terms of the amounts due
- Compliance with specific depreciation rules

The Commercial Code requires that the financial statements of mid-size and large stock corporations be audited by a certified public accountant appointed by the stockholders. Following the audit, the accountant must issue an opinion whether the accounting system, the financial statements and the annual report comply with the law and the corporation's own articles of incorporation. In small stock corporations the financial statements must be approved only by the supervisory board.

2.2.6 Liquidation

Reasons for Dissolution

Stock corporations may be dissolved

- When a pre-planned period of existence set forth in the articles of association expires
- Upon decision of a three-fourth majority of the voting stockholders
- If an adjudication of bankruptcy is declared

Further grounds for dissolution include:

- Court denial of a bankruptcy petition stemming from its estimation that the corporation lacks enough assets to cover the costs of bankruptcy proceedings
- A determination by the court of registry that a defect in the articles of incorporation exists
- The corporation is undercapitalized

The articles of incorporation may state yet further reasons and conditions under which the corporation is to be dissolved. When a ground for dissolution exists, the board of management must apply for the registration of the dissolution of the corporation in the commercial register.

The following extraordinary circumstances may also result in a formal end to the AG's existence:

- Corporate merger (*Verschmelzung*)
- Conversion of the AG into a business with a different legal form (*Umwandlung*)

In contrast to the grounds for dissolution discussed above, however, the occurrence of one of these three types of extraordinary circumstances does not result in the liquidation of the AG, which continues to pursue its original purpose, albeit in a different form.

Insolvency and Liquidation

The liquidation procedure of an AG is clearly prescribed by law. Basically, two kinds of liquidation proceedings are recognized. When insolvency is the cause for the dissolution, the liquidation procedures to be followed are those set forth in the Insolvency Act [Insolvenzordnung (InsO), Section 207f.]. This law grants special protection to creditors. For example, if the board of management determines that the losses of an AG exceed its stated capital or the corporation cannot meet its obligations because of insolvency, it must file a petition for bankruptcy with the local court within 3 weeks. Failure of the board to do so can make its members personally liable and subject to criminal prosecution. Creditors of the corporation also have the right to file a petition for its bankruptcy. The sequestrators are appointed

by the court. If insolvency is not the basis for the corporation's dissolution, the AG must be liquidated according to the procedures delineated in the Stock Corporation Law (Section 264 AktG). In accordance with these procedures, the members of the board of management serve as sequestrators unless the articles of incorporation or a resolution of the stockholders provide otherwise.

The sequestrators have to advise creditors of the dissolution of the AG by way of a notice published three consecutive times in the required newspaper or periodical. In the notice they must clearly request that any and all creditors submit their claims. All creditor claims including those of the tax authorities must be settled before any of the corporation's assets can be distributed among its stockholders. The distribution of remaining assets cannot occur earlier than 1 year after the third public notice to the creditors. Once the liquidation is complete and the final financial statements have been prepared, the sequestrators must file for cancellation of the entry of the corporation in the commercial register.

2.3 *European Corporation (SE)*

2.3.1 Nature and Formation

The European Corporation (*societas europaea*, SE) has been available as yet another legal form of business in Germany since December 29th of 2004. This form of business is based on a regulation of the European Community and is essentially modeled after the laws governing stock corporations. However, this kind of corporation can be founded by U.S. investors only if they have already started up several companies in different member states of the EU, which they can then consolidate into an SE. It is not possible to form an SE in any particular member state without already having a market presence there.

The SE is a business operation whose capital is divided into stock and which is an independent legal entity (as per Article 1 III SE-VO). SE law (Art. 2 SE-VO) makes it possible to start up such a company in any of four different ways. Stock corporations with registered main headquarters in the European Union can form an SE by way of consolidation, if at least two of the companies that are going to be integrated are subject to the national laws of member states of the EU. It is also possible to form a holding SE or an SE subsidiary through subscription of their stock. Finally, an SE can be founded by changing the legal form of an existing company. Non-EC companies cannot participate in the formation of an SE, as this is not permitted by German law.

An SE becomes a legal entity on the day it is registered in the commercial register. Any legal transaction made in the company's name before that day is not to the liability of the company, but rather of the persons acting in its behalf. If no agreement to the contrary exists, they are jointly and severally liable for such pre-registration transactions without limitation.

In terms of its organizational structure, an SE is required to have a stockholder meeting (Art. 38a SE-VO). Other than that, the SE statute gives the *individual SE*

freehand in deciding whether it wishes to be organized according to the (classical German) “dualistic system,” which separates the board of management (*Vorstand*) from the supervisory board (*Aufsichtsrat*) or according to the (mainly Anglo-American) “monistic system,” whose administrative organs are incorporated into one body. The choice is specified in the articles of incorporation at the time the SE is formed and can be reversed through amendment to the articles of incorporation.

2.3.2 Significance

An SE offers such a number of basic and fundamental advantages that it will motivate many holding companies, particularly those whose head offices are registered in non-EU countries, to consolidate the subsidiaries it has located in various EU countries in a single SE. One unified management team and a Europe-wide reporting system will presumably result in considerably lower administration costs. A unified company would furthermore make it possible to get around the notoriously difficult to resolve, cross-border issues concerning the qualification of dividend payments to the parent company including the determination of correct inner-company pricing.

A special characteristic of the SE is that it can relocate its registered office without first having dissolved the SE in the country it is leaving and forming a new legal entity in the country to which it intends to move. Hence the SE presents an alternative to the former, very complicated and involved practice of forming subsidiaries in each of the member states of the European Union in accordance with specific local laws.

3 Partnership Forms of Business Organizations

3.1 Civil-Law Partnership [*Gesellschaft des bürgerlichen Rechts* (Also Referred to as *GbR* or *BGB-Gesellschaft*)]

The civil-law partnership does not possess the status of a separate legal entity and is not registered in the commercial register. Nevertheless, it can act, sue or be sued under the companies name as if it is a legal entity.

The GbR may not be used as the organizational form for a business which falls under the definition of a *Handelsgewerbe*, or commercial trade enterprise owned and operated by individuals who are merchants by profession. It is most often used to govern relationships between several partners in a professional partnership engaged in the provision of professional services, such as a law office or any other group of independent professionals working in a joint office.

To form a GbR, at least two partners must enter into a partnership agreement (*Gesellschaftsvertrag*). This agreement need not be in writing, and the parties are usually free to agree to the terms they see fit, even if such terms are different from the provisions of the Civil Code (BGB) pertaining to this type of business. The law

requires only that the partners agree to the purpose to be promoted and combine their efforts in pursuance of a common economic objective (Section 705 BGB).

The assets of a GbR are held by all partners jointly (*Gesamthandsvermögen*, or joint ownership). The assets cannot be disposed of without agreement between all the partners (Section 719 BGB). The partners cannot transfer their membership and share of the assets to another person without the agreement of the other partners or unless provisions to the contrary were made in the partnership agreement.

All of the partners normally have the same rights. They jointly share in the profits and losses and equally participate in any liquidation proceedings. All partners have equal voting rights in the partnership meetings and are able to represent the partnership as a whole in their dealings with third parties only through joint participation of the other partners unless the partnership agreement provides for another form of representation. For example, if the partnership agreement so allows, the partners may appoint one or more managing partners and give them the authority to act on behalf of the partnership as a whole, according to the standard principles of representation, and to enter agreements with third parties that bind the company. According to the principle of self-organization a fully authorized manager must be a partner in the business.

The liability for obligations resulting from transactions conducted in the name of the partnership is carried by all the partners jointly and severally. Unless a contract with a given creditor provides otherwise, creditors with unsatisfied claims are entitled to sue the partnership and the members of the GbR as private individuals. In this manner, creditors can lay claim to the assets of the partnership as well as to the personal assets of its individual members. Debtors of the partnership, however, may not set off any claims they might have against a single partner against their liability to the partnership as a whole.

3.2 General Partnership [*Offene Handelsgesellschaft (OHG)*]

The Commercial Code (*Handelsgesetzbuch*, or HGB) makes provisions for the establishment of a partnership among merchants who wish to pursue a common commercial purpose under a common name (Section 105 HGB). That organizational form is the simplest among merchants engaged in trade and is the counterpart of the GbR – it is to merchants what the GbR is to professionals. It can be chosen by merchants only, or by people who intend to operate a commercial trade enterprise (*Handelsgewerbe*). The Commercial Code (HGB) clearly defines what constitutes a commercial trade enterprise.

The OHG is structured similarly to the GbR and is not a separate legal entity; nevertheless the OHG can sue and be sued under its name. The partners own the partnership property jointly (*Gesamthandsvermögen*), and all of the partners, or “general partners,” are personally liable for the company’s debts and other obligations (Section 128 HGB). The partners may be natural persons or legal entities. A legal entity may be partner in an OHG, however, only if it is engaged in merchant trading and corresponds in all respects to what the law defines as a *Handelsgewerbe*.

Persons forming an OHG do so typically out of a desire to achieve a true co-partnership to which the partners devote both their labor and financial resources. Normally each partner has the authority to act on behalf of the business and enter binding agreements in its name, which allows for flexible operations. Unlimited liability of all the partners, which is a mandatory characteristic of partnerships, improves the chances of these types of companies receiving bank credit if and when required.

The intense nature of the relationship of the partners in an OHG requires that each partner have confidence and trust in the reliability and abilities of the other partner(s). When such confidence and mutual trust are present, the OHG is a good form in which to organize a small or a mid-size enterprise.

The OHG comes into existence through its registration in the commercial register. Even in case that it is not registered, however, and a creditor issues a claim against it, the courts will rule that an OHG does indeed exist if a partnership agreement has been entered into and a transaction with a third party has taken place. The general provisions of the Commercial Code (HGB) apply to partnership agreements unless they contain contrary terms which are allowed under the Commercial Code.

The general partnership must be filed in the commercial register in notarized form. The application for the filing of the OHG must include the name, address and occupation of each partner, the company name and location as well as the date on which business will be commenced. All the partners must submit specimen signatures.

The company name of an OHG must contain the name of at least one of the partners in addition to a clear designation of the company as a general partnership (e.g., “Bernard Mueller OHG” or “Bernard Mueller & Co.”). Descriptive additions to the name are admissible, but they mustn't be either misleading or confusing. Any change in the company name or location or in the identity of its partners must be registered in the commercial register.

Although it is not a legal entity, a general partnership can sue and be sued (Section 124 HGB). Thus, a creditor of the OHG may sue the partnership itself under the company name as well as each of the partners individually. A private creditor of one of the partners, however, cannot file suit against the OHG itself.

At the end of each business year, the managing partners must prepare a balance sheet and have it approved and signed by all of the partners. The partnership agreement may require that this annual statement of accounts be approved at a meeting of the partners and/or examined by a public accountant. An OHG, like all other business enterprises, is obliged to conduct proper bookkeeping in accordance with the regulations of the Commercial Code (HGB).

Under the Commercial Code, reasons for dissolution of an OHG include a unanimous resolution of the partners, bankruptcy or the death of one of the partners. The partners can stipulate in their agreement other conditions under which the company can be dissolved. Should the stipulated conditions arise, any of the partners has the right to initiate dissolution proceedings by way of regular notice.

In the event that circumstances arise which make it unreasonable for the partnership to continue in existence, the law provides for the possibility to give extraordinary notice and subsequently file for special legal action seeking a dissolution order

(Section 133 HGB). The partner's right to seek such an order under extraordinary conditions cannot be restricted in the partnership agreement. Regardless of the reason for dissolution, the partnership agreement may contain a provision which allows the remaining partners to perpetuate the business.

3.3 *Limited Partnership [Kommanditgesellschaft (KG)]*

The KG is a special form of an OHG. It is formed by merchant partners for the purpose of operating a commercial business enterprise under a single company name. The rules governing the OHG (Sections 105 subs. HGB) are generally applicable to the KG unless modified by subsequent provisions of the Commercial Code (Sections 161 subs. HGB).

The main and most important difference between an OHG and a KG is that the KG consists of two different kinds of partners: personally liable partners (*Komplementäre*) and limited liable partners (*Kommanditisten*). As their designations clearly indicate, personally liable partners are liable for the debts of the company without any limitation. Their rights and duties correspond to those of an OHG partner. Normally, because they devote their labor and are subject to greater financial risk, personally liable partners are responsible for the company's management and representation. The liability of the limited liable partners, on the other hand, is limited to the amount of their capital investments in the partnership. These contributions can be cash, non-cash equivalents or even in the form of a substantiated claim against the company.

A KG must consist of at least one personally liable partner and at least one limited liable partner. Other rules regarding the KG's formation are similar to the requirements for the establishment of an OHG except that the different rights and duties of the two types of partners must be observed, particularly in the partnership agreement.

German law strictly differentiates between the external representation of a company and its internal management. As a rule, the power of the personally liable partners to represent the firm externally cannot be restricted to certain types of transactions or by general limitations. The only type of restriction which is effective vis-à-vis third parties is a joint-representation provision in the partnership agreement, which can provide either that the signatures of two or more personally liable partners is required in order to bind the KG or the signatures of two or more personally liable partners and the signature of another (such as a *Prokurist*) is necessary before the KG is bound. A KG which wishes to be governed by such a provision must file an application for the entry of it in the commercial register.

While it is not possible to deprive the personally liable partners of their rights of representation and the corresponding right of third parties to rely on them (external management rights), just the opposite is true of the limited partners. Due to their limited liability, the limited partners are not entitled to represent the firm unless they have been granted a full power of attorney (*Prokura* or *Handlungsvollmacht*).

With regard to the internal management of the KG, however, German law allows greater flexibility. For example, the partnership agreement may allocate certain types of responsibilities to different partners, exclude a partner completely from management or allow management participation of limited partners.

The limited partners have various controlling and information rights. In particular, they can demand copies of the year-end results and check their correctness by auditing the books and records of the business.

The obligation to prepare the annual balance sheet lies with the personally liable partners. However, the partnership agreement may also provide for the participation of the limited partners. A KG is subject to the same accounting, auditing and dissolution requirements as an OHG (see Sect. 3.2 above).

3.4 Silent Partnership (Stille Gesellschaft)

A silent partnership is formed by a partnership agreement. No registration or other disclosure is required. The silent partnership, therefore, remains a genuine internal affair between the silent partner and the principal who owns the business.

As a rule, the sole obligation of silent partners is to make a capital investment in accordance with the partnership agreement. Management rights are vested in the principal. Generally, silent partners have no more right to control the business than do the limited partners of a KG. Silent partners participate in the profits of the partnership, but usually do not share the losses. Silent partners usually have no claim to the hidden reserves of the business. The silent partnership differs from the limited partnership in that the silent partners, as opposed to the limited partners, do not appear externally and, despite its misleading name, the silent partnership doesn't function as a partnership in the market.

Silent partners are able to lay claim for repayment of their investments upon dissolution of the partnership. Unless the partnership agreement provides otherwise, silent partners possess the same rights as a creditors. This holds true even in the case of bankruptcy.

It is possible for the parties to agree that any silent partner(s) will participate in profits and losses upon liquidation and in the hidden reserves. Such an arrangement results in the creation of a "non-typical" silent partnership.

Foreign companies with German subsidiaries are often confronted with a situation in which their subsidiaries require additional funds. The silent partnership can be used to acquire such funds.

3.5 Professional Partnership (Partnerschaftsgesellschaft)

The professional partnership is a company formed for the purpose of practicing one of the free professions together. It is thus the complementary business form

for practitioners of free professions to the general partnership (OHG). Since the members of this partnership are not merchants engaged in commerce, they cannot form a trading company such as the OHG. Section 1 sentence 2 of the PartGG (Professional Partnership Act) specifies the free professions, which mainly include lawyers, certified public accountants, business consultants, doctors, dentists, engineers, architects, journalists, interpreters and instructors.

The professional partnership comes into being with the signing of a partnership contract and registration in the register of partnerships. Formation of such a company requires at least two partners; there is no such thing as a one-man partnership. In terms of its organizational structure, the professional partnership highly resembles the OHG. Registration of the company does not make it a legal entity in itself. However, it can nonetheless acquire certain rights, enter into obligations and sue and be sued in court.

Primarily, it is the partnership that is liable for its obligations. Additionally, however, all of the partners are jointly and severally liable without limitation. Nonetheless, the main advantage of the partnership as opposed to the GbR and OHG is that the law does offer the partners a certain limitation in their liability for the professional actions of the others: Section 8 of the Professional Partnership Act (PartGG) provides for limitation of any liability for malpractice claims to the partner who was responsible for performing the action or for managing and supervising its performance. Only that particular partner is personally liable without limitation.

A professional partnership does not have any special organs such as a board of management or a supervisory board as any corporation, but is represented by all of the partners in its external relations.

The dissolution and liquidation of a professional partnership occurs the same way as with an OHG.

3.6 *European Economic Interest Group [Europäische Wirtschaftliche Interessenvereinigung (EWIV)]*

The European Economic Interest Group (EWIV) is essentially a supranational legal form that derives from an EC regulation and, together with the SE, is the only business form that is a unique creation of European law. The purpose of this company is the facilitation of cross-border collaboration within the domestic European market.

The EWIV has to be comprised of at least two members – companies or natural persons – and at least two of its members must have their main administrative headquarters or main registered office in different member states of the EU. For this reason, the EWIV, like the European stock corporation, is not a suitable business form for American investors who are just starting up in Germany. Furthermore, the purpose of the EWIV is limited to non-profit activities. It cannot pursue any commercial objectives itself or make any profit. Instead, it is limited to promoting the economic interests of its members. Actual commercial business activity is reserved for them.

An EWIV comes into being with the signing of a formation agreement between the various members from different member states of the European Union and the registration of it in the commercial register. As viewed by German law, an EWIV is, in terms of its structure, a partnership to which the laws of the OHG loosely apply, which is to say that it is not a legal entity. It does, however, have rights and obligations and can sue and be sued in court in its own name. The members of the interest group are jointly and severally liable for all of its debts without limitation. In other words, all of the members are liable for any losses made by the EWIV. They are not required to pay any membership dues as long as the organization is able to operate that way without making a loss.

Necessary organs of an EWIV are the jointly operating members, who comprise the major organ of the group, and the managing director.

An EWIV can be dissolved at any time by unanimous vote of its shareholders. It is also possible for the organization to be forcefully dissolved by a court order.

4 Mixed Corporate/Partnership Organizational Forms

4.1 *GmbH & Co. KG*

The GmbH & Co. KG is a form that combines the limited liability company (GmbH) with a limited partnership (KG) and is frequently used in Germany. The advantage of this form of business organization is the fact that a GmbH may (and usually does) participate as the only personally liable partner of the KG, thus limiting the liability of the only personally liable partner. The GmbH can be held liable for its business debts only to the extent of its assets. Its liability cannot be extended to the private property of its shareholders. Therefore, there is no real unlimited liability of any of the partners in a GmbH & Co. KG.

When the GmbH is the sole personally liable partner, it has the duty of managing and representing the GmbH & Co. KG. The GmbH fulfills its responsibilities in this regard through the efforts of its own managing director(s).

4.2 *Limited Partnership with Stock [Kommanditgesellschaft auf Aktien (KGaA)]*

The KGaA is another mixed type of partnership/corporate form available for use in Germany. Though it is relatively rare, some of the largest enterprises in Germany have chosen to use it. It possesses attributes of both a limited partnership as well as a stock corporation. Like a corporation, it is a separate legal entity. As opposed to a stock corporation (AG), the KGaA must have at least one partner who is personally liable (the *Komplementär*). That partner, however, can be a GmbH, or limited

company. The KGaA differs from a limited partnership (KG) in that it issues stock, which is purchased by the limited partners.

The limited stockholders are entitled to participate in the corporation's affairs only through concerted action taken at stockholder meetings. The personally liable partner(s) are responsible for the management and representation of the company.

5 Other Business Organizational Forms

5.1 Sole Proprietorship (Einzelunternehmen)

The sole proprietorship is one of the most popular organizational forms for small businesses due to the comparative ease with which it can be formed and operated. In general, a small merchant is not required to register the proprietorship in the commercial register.

Sole proprietors, like the general partners of an OHG, are subject to personal liability for all the debts of the business. Consequently, their private assets can be impounded if necessary in order to satisfy the claims of creditors. If sole proprietors are engaged in the types of merchant trade, then they are considered to be operating *Handelsgewerbe* and must register the business.

5.2 Branch Office (Zweigniederlassung)

Instead of or in addition to the formation of a new enterprise, it is often advisable for a foreign company to set up a branch office (*Zweigniederlassung*) in Germany. Tax advantages often play an important role in such a decision. On the other hand, a parent company is liable to the full extent of its own assets for creditors' claims filed against the branch.

A branch has no legal personality of its own and thus derives its rights and obligations from the status of the head office of the parent company. The legal formalities that have to be taken into consideration when setting up a branch office in Germany and the differences between a branch office and a mere operational location (*Betriebsstätte*) are the subject of a separate chapter.

6 Corporate Succession and Changes of Organizational Form

The business development of an AG, GmbH or KGaA can result in the need or desire for a conversion of the company into a different legal form (*Umwandlung*), a merger by takeover (*Verschmelzung durch Aufnahme*) or a consolidation with another corporation for the purpose of forming a new corporation (*Verschmelzung durch Neubildung*).

6.1 Mergers and Consolidations

A merger takes place under German law when the total assets and liabilities of one corporate enterprise are transferred to another in return for shares in it. As a result of a merger, the transferee company is terminated and its shareholders become shareholders in the acquiring corporation [merger by takeover (*Verschmelzung durch Aufnahme*)].

A consolidation occurs when the assets and liabilities of two or more corporations are transferred to a newly formed corporation in return for shares in this new corporation (*Verschmelzung durch Neubildung*).

The following types of enterprises in particular can be fused through either a merger or a consolidation:

- General or limited partnerships (OHG/KG)
- Limited partnerships with stock (KGaA)
- Stock corporations (AG)
- GmbHs

6.2 Conversion

In contrast to a merger or consolidation, a conversion impacts only one business by changing its organizational form. Under the provisions of the Conversion Act (*Umwandlungsgesetz*) GmbHs, AGs, and KGaAs may be converted into general partnerships (OHGs), limited partnerships (KGs), GbRs, GmbHs or a different AG. On the other hand, GbRs, OHGs and KGs can only be converted into GmbHs, stock corporations or KGaAs.

The conversion of an AG into a KGaA requires a resolution passed by a three-fourth majority vote of the stockholders. The conversion of an AG into a GmbH, however, generally requires the unanimous approval of all the voting stockholders. The conversion of an AG into a KGaA must be approved by each of the individuals who, through the conversion, will become the personally liable partners of the new company.

In order to convert an existing GmbH into an AG or a KGaA, the shareholders must pass an amendment to the articles of incorporation reflecting the change. An application must be made to have the names of the members of the board of management of the newly created stock corporation and the conversion itself filed in the commercial register. With the registration of the conversion, the continuity of the business operations of the GmbH is legally ensured; its rights and obligations are carried over to the newly formed stock corporation (AG) or limited partnership with stock (KGaA). Its share capital becomes stock capital, and its shares or ownership interests are converted into stockholdings.

Establishment of a Company or Branch Office

T. Fischl

1 Alternative Ways of Doing Business in Germany

Foreign companies planning to do business in Germany in order to expand their business or for investment purposes have various alternatives available to them. The legal organization of their business activity can take place in the traditional way by establishing a local subsidiary or branch office.

1.1 Subsidiaries

In legal terms, a subsidiary is an autonomous business enterprise that is established by an existing parent company. The formation of a subsidiary is subject to the particular set of corporate laws applicable to the legal form chosen for the business.

There are no special legal conditions or restrictions applicable to foreign companies interested in establishing a subsidiary. Foreign companies are subject to exactly the same, exclusively German laws and regulations that local companies are subject to with regard to the establishment of a business and the registration of it with both the Trade Supervision Office (*Gewerbeamt*) and the Commercial Register (*Handelsregister*).

Hence, all of the same options are available to a foreign company as to a local one when it comes to selecting the most appropriate organizational form for the planned business venture. Each of the various organizational forms has a different procedure for its establishment. A concise overview of the requirements that each type of business organization has to fulfill upon its establishment is presented in the article “Recognized Forms of Business Organization.” By way of supplement, the requirements for registration in the commercial register and, if necessary, with the Trade Supervision Office, which also apply to the establishment of subsidiaries, will be dealt with below.

1.2 *Branch Office (Niederlassung)*

Instead of or in addition to the formation of a new subsidiary company, it is often advisable for a foreign company to set up a branch office (*Niederlassung*) in Germany. Tax advantages often play an important role in such a decision. On the other hand, a parent company is fully liable to the extent of its own assets for any claims creditors might assert against the dependent German office.

A branch office can be established either as an independent branch office (*Zweigniederlassung*) or an operational location (*Betriebsstätte*), which is a fully dependent branch office. German law makes a sharp distinction between independent and dependent branch offices.

1.2.1 *Independent Branch Office (Zweigniederlassung)*

Legal Personality (*Rechtspersönlichkeit*)

An independent branch office is not an autonomous legal entity separate from that of the business headquarters. An independent branch office is a part of a company that is permanently separated from its headquarters, geographically and in terms of its internal processes, and operates independently to a very large extent, keeping and balancing its own books. Its business activities are based on the same subject matter as those of the headquarters and cannot be limited to mere support or implementation tasks.

It is legally and organizationally part of the headquarters business operation and is, therefore, subject to the laws governing the main company. If the branch office is established by a foreign company, it is dependent on the foreign law applicable to the main company.

In general, a branch may sue or be sued only through the main company. However, by virtue of its local presence the German branch office of a foreign company can have action taken against it by local creditors through the local judicial system. Also, since an independent branch office is not an autonomous legal entity but rather an integral part of the main company, any obligations or debts incurred by the branch office are the legal responsibility of the natural person or legal entity that comprises the main business.

Organization

The organization is led by a manager who has the power of external representation, even though he may receive orders from company headquarters. It is a bona fide independent branch office only when, from an overall perspective, it can be seen that, in terms of personnel and organizational structure, it constitutes an independent organizational unit that could theoretically function fairly easily on its own, even if the company headquarters did not exist.

As concerns material matters, a separate share of the company assets must be allocated to the branch office. It also has to be equipped in a way that enables it to independently participate in everyday business activities and, thereby, fulfill its purpose.

Corporate Name (*Firma*)

Since the branch office is not an autonomous company but rather an integral part of the corporation as a whole, the name of the branch office is generally identical to the name of main company. The name of the main company and hence the name of the branch office is subject to the laws of the country or state in which the corporate headquarters are located. However, an application to have the branch office registered in the German commercial register will be rejected if its corporate name does not conform with the German public order (Article 6 EGBGB).

As a general rule, the name of the company headquarters and an indication of its legal form must appear unaltered in the name of the branch office of a foreign or domestic company, even though it may mean the retention of foreign words. If the foreign laws governing the corporate name do not require an indication of the company's legal form or if the indication of the legal form is neither in common use in Germany nor understandable to most Germans, a clarification tag is required to avoid potential confusion. Tags such as "*Niederlassung München*" ("Munich Branch") are also possible.

Formalities

All of the commercial activities of an independent branch office have to be reported to the Trade Supervision Office. Usually, no special licenses are required unless the planned business activity of the branch office falls into a special category. Businesses requiring a special license, to cite some of the most common examples, include banks, restaurants, hotels, bars, insurance companies and passenger transportation lines. Failure to provide the required notification and obtain the necessary permit can result in a substantial fine.

Furthermore, it is necessary to file for registration of the company in the commercial register (*Handelsregister*). Upon doing so, the branch office will receive its own registered location, its own commercial register number (HR number) and will be assigned to its own court of jurisdiction. All of the relevant information and documents concerning the establishment of the branch office must be submitted to the commercial register in notarized form when filing for registration. In the case of an independent branch office of a corporation with foreign headquarters, the following items would be included:

- A copy of the registration of the main office insofar as the country or state laws of the place where it is located require registration
- Statement of the main company's legal form

- If the company is not subject to the laws of a member state of the European Community or those of another state that is a partner to a treaty regulating its participation in the European Market, explicit mention must be made of the body of national laws that the main company is subject to
- The corporate name and registered location of the company headquarters
- The corporate purpose
- The official date on which the company was incorporated
- The full names of the managing directors (Geschäftsführer) and/or the board members (Vorstand) of the corporation and their signature powers
- The nominal capital or capital stock
- Planned duration of the company (if temporary)
- The address and purpose of the branch office
- The amount of working capital available to the branch office
- The date on which the resolution to form the branch office was passed
- The full names of the managing directors and/or board members who will have the authority to represent the branch office in and out of court and the extent of their powers of representation
- Planned duration of the branch office (if temporary)
- Proof of the existence of the parent company
- If the particular business the company is in requires a license under German law, proof of the existence of such a license is to be attached
- A notarized copy of the articles of incorporation (Gesellschaftsvertrag) of the company accompanied by a certified translation of the same if the original is not in German
- The application for entry of the branch office in the commercial register must be signed by all the officers of the company in the presence of a notary. Normally their signatures must be submitted to the German consulate for verification but, according to the Hague Convention of October 5th, 1962, this requirement can be met by attaching an apostille to the application. An apostille is a certificate of authenticity that is attached to the notarized document by the local authorities in the country where the branch office is being set up. The Convention is also valid in the United States

The Registration in the commercial register was substantially accelerated by the Act on Electronic Commercial Registers, Registers of Cooperatives and Business Registers, which came into force at the beginning of 2007. The documents required may be submitted electronically to the court. The court is able to allow a direct entry of the data in the register it keeps electronically.

If a foreign corporation wants to set up several branch offices in Germany, it can select the commercial register of one district as its main register. Then it only has to send all of the items listed above to that one particular registrar's office.

The following documents must be submitted to the Trade Supervision Office:

- Proof of the identity of the applicant (passport or official I.D. card) as well as proof of his power to represent a third party (natural person or legal entity) if applicable
- Any state permits required
- Foreigners must submit a residence permit issued by the local authorities that include permission to engage in self-employment in Germany
- Companies registered in a foreign country must submit proof of registration together with a German translation. Certification of the translation is generally not required
- Foreign companies must submit the name of a local representative as well as a local address. The local representative must submit a power of attorney issued in his name

1.2.2 Dependent Branch Offices (*Betriebsstätte*)

The setting up of a dependent branch office is the simplest organizational alternative available to any domestic or foreign company that already has a registered office in Germany and would like to do business from another location as well. The same company can have several dependent branch offices. A dependent branch office is dependent on the main office in every respect. Its operations are unified and the only difference is that the branch office is on a different location than headquarters. Even its invoices are issued in the name of the head office.

A dependent branch office is not officially registered. However, every branch office must report its business activities to the local Trade Supervision Office. The formal application procedures are the same as those described above. Since dependent branches are involved in the same operational procedures as the head office, simply performing their part on a different location, they are not allowed to have company names that are different from that of the head office.

1.2.3 Representative Organizations (*Repräsentanzen*)

It is often the case that companies interested in setting up branch offices in Germany, especially foreign companies, mention the terms “local representation” when referring to the kind of organization they wish to create. However, German commercial law makes no provision for a purely “representative organization” (*Repräsentanz*). It holds that a representative office is either an integral part of a single company with a German head office and is actively involved in business operations itself (in which event it is a dependent branch office) or it is an office that was founded with the intention of having it operated by an external self-employed merchant, such as a sales representative (*Handelsvertreter*), with a special internal contract, in which event the foreign company itself is not actively involved in the German market.

2 Legal Requirements for Non-Citizens

If subsidiaries or branch offices are to be managed and operated by non-citizens of Germany, the parties in question have to be in possession of a residence permit that grants them general permission to engage in the kind of work anticipated. A residence permit is required whenever the person in question is planning to stay in Germany for an extended period of time. However, if the person in question intends to retain his or her usual place of residence abroad and merely travel to Germany from time to time, no special residence permit allowing commercial activity is required.

The above requirements do not apply to citizens of the member states of the European Union, citizens of foreign states that are not members of the EU but belong to the European Market [*Europäischer Wirtschaftsraum* (EWR)] and citizens of states with which Germany has special economic agreements (e.g. the United States).

The Acquisition of Closely Held Companies

B. Tremml

The structure as well as the content of the rules and regulations of German law may appear strange to a person more familiar with Anglo-American law. For example, in Germany, whenever parties have no written agreement on a particular issue, the law, as it is interpreted by the courts, will apply or impose a solution. Thus, a party that might have forgotten to address a particular issue does not remain completely unprotected.

Such judicially imposed contract terms are, however, often viewed as very unsatisfactory by either the purchaser or seller of a business enterprise. To clarify matters from the onset and avoid such judicial impositions as well as the hassles and high costs of litigation, it has become common practice for the parties in an acquisition transaction to agree to specific terms that are within the range of the law and clearly lay them out in the form of a written contract.

An acquisition involves such diverse areas of law as contract, commercial, corporate, labor, and tax law and sometimes even inheritance or domestic-relations law. Through a contract, the laws can be tailored to meet the needs of a specific case, which offers both the seller and purchaser considerably better protection. It is imperative that significant attention be focused on the drafting of the acquisition contract.

1 Types of Acquisition

As discussed in the previous chapter, German law provides for a variety of business organizational forms, which can be divided into sole proprietorships, partnerships, corporations and forms that are a mixture of the latter two. Only a relatively small number of German companies issue stock and trade it on the open market. As mentioned, the stock corporation (AG) is chosen by only a handful of large and mainly international enterprises, and because its stock is freely traded, there is nothing its management can do to prevent a purchaser bent on acquiring a majority of stocks from getting them. Therefore, in terms of acquisition, it has a unique status. All the other types of enterprises are customized to meet the needs of their owners, and as a general rule, their equity holdings are not openly traded or even freely transferable. They can, therefore, be described as privately or closely held

enterprises. This chapter will deal primarily with the acquisition of GmbHs, the legal form of a closely held company that is most commonly chosen by mid-sized German enterprises.

There are two ways to acquire in whole or in part, any kind of already existing German enterprise: the acquisition of ownership interests (the equity holdings of a GmbH or the stock of an AG, for instance), so called “share deal”, or the acquisition of all or some of its assets and liabilities, so called “asset deal”.

1.1 Acquisition of Ownership Interests

As a rule, all the rights of ownership are transferred from the seller of a GmbH to the buyer on the date of purchase. That means that the legal entity itself is transferred which retains ownership of the assets.

Prior to the acquisition, an interim balance sheet must be prepared showing the expected profits up to the date of sale, which is the date the equity holdings of the GmbH together with the right to receive future profits are transferred to the buyer. Any necessary adjustments to the interim balance sheet must be made in accordance with the final financial report.

1.2 Sale of Assets

The sale of assets is quite complex because a great degree of specificity is required and detailed attention must be given to the matter to avoid the possibility of error. Each item of property, as well as all the rights and liabilities associated with it, must be accurately and clearly listed in the acquisition agreement.

1.2.1 Real Estate

The conditions of ownership and a detailed description of any real estate property can be conclusively determined from the information contained in the real estate register. Buildings constitute an integral part of the real estate. Appurtenances such as machines are included in the sale of real estate unless otherwise agreed. The transfer to the purchaser occurs when an agreement by both the seller and the purchaser has been entered into before a German notary public and the transfer has been officially noted in the real estate register.

1.2.2 Purchase of Current Moveable Assets or Groups of Moveable Assets

If current moveable assets or groups of moveable assets are sold, the individual items must be accurately and clearly listed in the acquisition agreement. With groups of

assets, a purely quantitative description (i.e., “100 units”) is not sufficient. Assets must be identified according to time and place, which is achieved by applying the so-called “All-Formula” rule in such a manner as to signify, for example, that all the items located in a particular stockroom or warehouse on the date of purchase will be conveyed to the purchaser.

Current moveable assets and groups of moveable assets are often encumbered by third-party security rights. It is important to treat such items separately in the agreement, since they could be excluded from the transfer. However, it can also be agreed that the sellers’ right to have such an item released or conveyed to them upon satisfaction of the claim for which it was offered as security, is transferred to the purchaser. The transfer of title to movable objects is effected by conveyance, or if a third party is in possession of the object, by surrender of the right to possession.

1.2.3 Claims

Claims can be transferred with the informal consent of the creditor and purchaser without the consent of the debtor. The claim may be substantiated through a designation of the underlying transaction or the name of the debtor. If the purchaser intends to continue to operate the business of the seller after acquisition, the designation “all claims of the seller resulting from operations of the business” effectively serves the purpose. Such claims then become the enforceable claims of the purchaser. To avoid unpleasant surprises, the purchaser should, as in the case of the purchase of movable objects described above, insist on a detailed record of all outstanding claims. As a further security measure, the purchaser should obtain a personal guarantee from the seller that those claims will be satisfied by the seller in the event of default.

1.2.4 Company Name and Special Industrial Property Rights

A company name can be transferred along with the sale of the company as a whole. The express agreement of the seller is, however, necessary for the continued use of the company name by the purchaser. Applications for change of registration and notarized transfer registrations should be made at the time of the closing of the sale.

Patents can be transferred separately, and as a rule they are transferred whenever the assets of the firm are transferred as a whole. If the rights resulting from a patent or design should need to be asserted against a third party, the transfer must have been previously registered. Often patents or designs are registered in the name of the previous owner. Therefore, verification is indispensable.

1.2.5 Additional Rights and Obligations

All remaining rights and obligations, any contracts which are to be assumed and any intangible assets such as know-how, customers, good will and so on should be

listed in a manner as accurate as possible. When the transfer of a right is not regulated by applicable law, the pertinent details must be agreed upon. Also, the extent of any corresponding guarantees and indemnities of the seller should be set forth as clearly as possible in the sale's contract, because they may be a purchaser's only recourse in case of a failure in the transfer of any such right. Of course, an accurate description of the right or obligation also serves to provide a dependable basis for the calculation of the purchase price. Because the transfer of a contract containing an assumption of debt requires the agreement of the creditor, a three-party agreement among the seller, the purchaser and the creditor will have to be made, or consent of the creditor to the transfer will otherwise have to be secured.

2 Contract Formalities

2.1 Letter of Intent, Negotiation Contracts and Preliminary Contracts

2.1.1 Liability During Contract Negotiations

Acquisition contract negotiations cost both time and energy. Expenses prior to and in anticipation of the execution of the contract are often incurred, and more often business secrets are revealed. Thus, the question of how the relationship between the parties should be regulated during the preliminary stages of contract negotiations arises.

As a general rule, negotiations alone do not obligate the parties to enter into an acquisition contract. In theory, the negotiations can be broken off without any reason, and it is possible to engage in parallel negotiations with other parties. Nonetheless, the law imposes a fiduciary relationship between the negotiating parties, which obligates them to observe and respect the just interests of the other.

A foreign purchaser may be surprised that even before any contractual obligations are incurred, a negotiating partner is liable for damages in accordance with the rules of *culpa in contrahendo* (anticipatory breach). For example, if a potential purchaser makes personal use of a business secret that he or she becomes aware of during the course of negotiations, he or she is liable for any damages. Also, even in the absence of any intent to cause a loss, if a purchaser or a seller breaks off the negotiations without justifiable reason, he may be liable for damages the other party sustains through "detrimental reliance." Such damages might be, for instance, the irreversible expenditures the other party incurred by relying on the probable execution of the contract, expenditures which, upon the breaking off of the contract negotiations, constitute a definite loss.

2.1.2 Letter of Intent and Negotiation Contracts

German business practice uses a letter of intent as part of preliminary contract negotiations. According to German law, such a letter is in principle a pure declaration of

intent. It is meant to preclude adverse legal consequences and not to obligate a party to execute a final contract, even if a party states that under certain circumstances it is willing to be bound to do so. It should be noted, however, that the negotiating parties may rely on the probable execution of a final contract if the wording of the letter of intent seems to assume that a final contract will be entered into. The possibility of liability for reliance injury is obvious in such a case.

In order to preclude the risk and uncertainty of being sued for damages based on “detrimental reliance” in the event the contract negotiations are terminated, it is highly advisable to contractually determine the relationship the parties will have during the negotiation stage.

A preliminary agreement can include certain performance or disclosure obligations and/or a unilateral obligation on the part of the seller not to conduct any negotiations with third parties up to a certain point in time (according to German law, such a unilateral obligation is enforceable without the providing of consideration by the purchaser). The parties’ agreement regarding their obligations during the negotiation stage can be laid out in the letter of intent.

However, a letter of intent which is used this way and contains provisions concerning certain performance or other obligations during the on-going contract negotiations, constitutes a binding offer to perform in accordance with the obligations. Its acceptance results in a so-called negotiation contract, the parties can, for example, agree to and be bound by the following obligations:

- Performance obligations (such as the conduction of preliminary investigations, marketing and location analyses)
- Disclosure obligations (such as balance sheet audit, disclosure by designated employees)
- Secrecy obligations (agreement not to use acquired information to one’s own or to a third party’s advantage)
- Obligations pertaining to liability for omissions and reimbursement for expenses (including expert opinions, attorney fees, etc.)
- And obligations regarding dispute resolution (choice-of-law clause for the preliminary contract negotiations and arbitration agreements)

It is very important that the negotiation contract state whether these obligations are to remain in effect after the execution of the acquisition contract or whether they are to be extinguished by or integrated into the provisions of the acquisition contract.

It should be mentioned that the involvement of a broker (in practice often banks) can serve the secrecy requirements of the seller as well as the purchaser. A broker’s professional expertise can, furthermore, be of great advantage to the prospective purchaser.

2.1.3 Preliminary Contracts

When the basic terms regarding the acquisition contract are settled, a preliminary contract can be entered into even if certain issues still require further clarification.

Such a preliminary agreement will impose an obligation on the parties to enter into a final acquisition contract.

2.2 Requirements of Form

As a general rule, a contract for the sale of a partnership (other than a GmbH & Co. KG) which does not involve the transfer of real property need not conform to a specific form or meet specific legal requirements other than those pertaining to the enforceability of contracts in general. Contracts regulating the sale of all the assets and equity holdings of a GmbH, however, must conform to specific legal requirements.

GmbH law (GmbHG) requires that the sale and transfer of equity holdings of such a company be effected by a German notary public (“Notar”). A “Notar” is a person who has the same training as an attorney but who acts impartially in a quasi-governmental function. A “Notar” must be involved in the transfer of the holdings of a GmbH, regardless of whether their sale amounts to a partial or whole transfer of ownership.

Merger agreements through which an AG or GmbH transfers its assets as a whole to another corporation (merger by amalgamation) or by which several corporations or closely held companies such as a GmbH transfer their assets to a new corporation (merger by consolidation), must be notarized and require compliance with the applicable statutes. Among other requirements, both companies must have their principal place of business within the Federal Republic of Germany. In practice, however, mergers are extremely rare.

If the contract is void because the special notarization requirements of the GmbH law have not been met, the purchaser has the right to be reimbursed in an amount equal to the sales price already paid. That right stems from the principle of unjust enrichment. The purchaser, however, will have to refund any profits obtained from the company if he or she knew or was grossly negligent in failing to realize that the contract was void.

3 Specific Sale Considerations

3.1 Pending Litigation

Upon the acquisition of the equity holdings of a GmbH, the company remains party to all on-going litigation and liable for any judgment. In order to avoid conflicts, key points such as the following should be settled in an acquisition agreement:

- The seller should disclose whether any and what kind of suits are pending (and what type of litigation is to be expected according to the best of his or her knowledge)

- The seller and purchaser should jointly defend on-going suits, subject to their agreement concerning the nature and extent of each of their obligations
- The parties should determine whether, depending on the outcome of pending litigation, the object of dispute will be re-transferred to the seller and, taking that prospect into account, make the necessary adjustments in the purchase price
- And the parties should reach an agreement concerning the right of either of them to appeal, recognize, settle, or dismiss actions and determine which one of them will be liable for the legal costs involved

3.2 Legal Liability of the Purchaser for Obligations

When the purchaser acquires the equity holdings of a GmbH, the GmbH as a legal entity remains liable for its existing obligations. Personal liabilities of either the seller or purchaser or both can nevertheless arise. Sellers are liable, for instance, if they have fallen into arrears in their payments of the original capital investment or in their fulfillment of additional service obligations.

Seller and purchaser will be jointly liable, according to their proportionate share holdings, for any overdue obligations to the GmbH which result from the share holding duties and which were not satisfied by other owners. In any case, the purchaser must have full knowledge of and access to the GmbH documents (“Gesellschaftsverträge”) which clearly define the rights of the owners and their financial obligations.

3.3 Labor Law Requirements

The complexity and impact of German labor law on business operations tends to cause potential foreign investors serious concerns, and may in fact prevent a successful acquisition.

Purchasers typically desire to retain those employees needed for a successful perpetuation of the company’s business activities, and it is important that they take the proper steps in doing so. If a previously independent company is incorporated into a larger business structure, the loss of autonomous decision-making power often encourages management and executive personnel to resign.

On the other hand, company purchasers have the legal obligation to assume existing employee relationships, although they may have no interest in doing so or may wish to change the relationships. This might occur, for instance, when someone acquires stock or equity holdings in a company. Employee relationships remain unchanged in that case, as there was no actual change of employer. Since German labor laws have such an enormous impact on business operations, it is essential that potential foreign purchasers familiarize themselves with the laws and their implications.

Germany has very clearly spelled out employee-dismissal regulations, and there is only a limited number of legally recognized conditions under which employment can be terminated. Its labor laws also include special protective measures for employees based on age, seniority, maternity or the presence of a handicap. These employee-friendly laws may seem as unusual and surprising to foreign purchasers as the obligations employers have under certain circumstances to continue making wage payments to employees on leaves of absence. The high degree of German employee protection, insurance, vacation and other benefits tends to cause initial astonishment, as does the fact that German labor laws grant employees the right to participate in company management and co-determine its policies. These aspects will be dealt with in the chapter, "Aspects of German Labor Law".

Upon becoming the new owner of an enterprise, a purchaser automatically assumes from a legal perspective all the employment relationships that currently exist in the enterprise. It should also be noted that employees have the right to object to a transfer of their employment agreement to the new owner. If their objections are sustained, the seller will remain the employer. The purchaser is liable for all of the overdue wages owed to employees who are still in the company's retention at the time of acquisition. The seller and purchaser are jointly liable for all obligations which accrued prior to the acquisition and are due within a year after the transfer. Thus, the seller and purchaser have to regulate such liability between themselves in the form of a contract. For the most part, however, only the seller is liable for the claims of any employees who resigned prior to the acquisition. The purchaser needs to be aware of potential exceptions to that rule. Following a successful acquisition, the purchaser also becomes liable for vested interests in retirement payments and the pension commitments the company has made to its employees.

German labor laws grant employees special protection rights in the event of an acquisition. Their employment cannot be terminated as a direct result of it, which is to say that terminations stemming from the transfer of a company from one owner to another are legally prohibited. The termination of personnel following an acquisition is allowed only within restriction; for example, if restructuring plans were already in place at the time of the sale and there are objective reasons why the personnel affected by them cannot continue to be employed. The law also provides that upon acquisition the existing terms of collective-bargaining agreements and the existing wage-and-salary structures continue to be valid and binding. They cannot be changed if that would have an adverse effect on the employees, whose interests, by law, cannot be limited or abridged as the consequence of an acquisition.

Furthermore, it is important to note that as the result of an acquisition or merger the company's employees might gain the right to be represented on certain of its administrative boards. If, as a result of the sale, the company now employs more than 2,000 people, the right of employee participation in management comes into effect. The company must provide for employee representation on the supervisory board ("Aufsichtsrat").

In summary, the necessity of pre-sale legal review of all the labor-law issues and implications involved in an acquisition cannot be underscored too strongly. A potential purchaser should be well informed about the legal situation and take the necessary

measures of protection in advance of purchase in order to avoid costly, never-ending future litigation (see chapter “Enforcement of Rights and Claims Through the Courts”).

3.4 Breach of Contract

It is of particular importance to a purchaser to know what the legal outcome will be if the actual assets of a business enterprise were incorrectly represented in the purchase agreement or if the enterprise does not develop as projected and described in the agreement. If no contract provisions address these issues, then the following prevails.

Because the sale of stock or equity holdings is an effective legal transaction, sellers are liable only for the legality of the ownership interests. That is to say, they are not responsible for the conditions of whatever it is the ownership interests entitle their holders to (the assets of a company). The purchasers of stock or equity holdings are protected by law, only when they in effect acquire the entire enterprise. Yet even in that case, the seller can be held liable only for the lack of those assets whose absence would undermine the very existence of the enterprise as a whole. For example, a seller would be liable for a material deficiency that might exist in discrepancy to the capital asset account. The seller, however, is not generally liable for any incorrect statements concerning sales, profits and profitability or the total amount of the existing liabilities. Prospective purchasers are, therefore, well advised to demand specific warranties from the seller of a business, and this in writing, as their chances of holding the seller liable for any statements, indications or promises would otherwise be very weak indeed. A written warranty, however, would serve as a court-recognized basis for proving deception and/or damage and make it possible to tag an appropriate monetary figure to it. This warranty should be an integral part of the attorney-prepared purchase contract if it is to have the full potential to stand up in court.

Since purchasers of closely held companies are at a relative disadvantage to the sellers and since there is a great deal of ambiguity concerning their rights and obligations in general, it is highly recommended that all unclear and open issues be resolved in writing. In how much detail the various issues ought to be treated depends largely on the negotiating parties. However, the minimum to be obtained from the seller should be a guarantee concerning the net assets and profits of the enterprise. It should include attests to past business performance and to existing or non-existing transactions as well as to realistically projected future developments. In conjunction with such an agreement, the form and extent of the seller’s liability should be agreed upon.

The seller should also guarantee that the balance sheet is complete and accurate, was prepared in accordance with the proper, legally proscribed accounting principles, and will be updated by way of supplement if necessary. The parties should also make an agreement as to what independent certified public accountants will verify the balance sheet. Procedures for any necessary adjustments of the purchase

price should also be clearly laid out. The seller should be asked to provide warranties regarding the firm's inventory, hidden reserves, high-risk transactions and sale restrictions as well as warranties pertaining to the validity of any operating permits and licenses. The statement procured from the seller should also contain mention of any provisions governing the transfer of know-how and any restrictions, geographical and otherwise, on competition. Such restrictions may also apply to the prior owner's right to use his or her name in another business. The seller's obligations to disclose pending litigation and other liabilities can be supported by a guarantee that the information was provided to the best of the seller's ability and knowledge.

A mechanism should also be in place for establishing the liability of the seller and determining the type and extent of damage for which the seller is responsible. It is to the advantage of both parties to agree to a purchase price reduction rather than to the purchaser's right to rescind a sale in the event that the seller becomes liable for certain damage. Provisions for the right to rescind a sale should be made only in the most extreme cases. It is also general practice to extend the standard 1-year duration of warranty obligations to 2 years by way of written agreement.

3.5 *Expenses*

Expenses incurred through the acquisition of an enterprise should be covered in the agreement. Attorney and notary public fees are legally fixed in Germany. The amount is determined according to the value of the matter in question. In the case of a whole-company acquisition, the value of the company determines the amount of the legal fees. When stock or equity holdings are being transferred, the legal fees are based on either the total nominal capital or the purchase price of the holdings. If individual assets such as real estate are being sold, the fees are based on the assets' current market value. For example, if the acquisition price of the equity holdings of a closely held corporation such as a GmbH is € 250,000–, the attorney will be entitled to up to € 6,800.– and the notary public who certifies the sales contract and the assignment of the equity holdings will be entitled to € 1,750–. Variation in these fees is allowed in individual cases; usually attorneys charge in acquisition cases hourly fees, ranging from € 200– to € 400–. Further expenses include the costs for the registration of the equity holdings in the commercial register or, in the case of the transfer of real estate, in the real-estate register. Those fees are comparatively lower.

4 Restrictions

4.1 *Restrictions on Sale*

Prospective purchasers should make themselves aware of any restrictions the seller might have on the rights to sell the object in question. If any restrictions exist, the

sales contract could be void or ineffective until the necessary approvals have been granted. Special areas such as family (domestic relations) and inheritance law, will not be considered here, although they may be of high impact and should not be overlooked when considering a purchase.

The purchaser of an enterprise has to know who is authorized to effect its sale. The sale or merger of an AG cannot be agreed to by the board of management or supervisory board alone, but requires the consent of a qualified majority of the stockholders at a general meeting. Such consent can be dispensed with only if a part of the enterprise is being sold and the corporation can continue its activities in conformity with its existing articles of incorporation. In the case of the sale of a GmbH or other closely held corporation, it is not clear whether the power of a managing director is sufficient to effect the transfer of the company or whether a meeting of owners must be called and a resolution authorizing the transfer adopted by a qualified majority. Thus, it is advisable to insist on such a resolution. It should be noted that the transfer of ownership interests of a closely held corporation can be restricted by the articles of incorporation, and the transfer can be made subject to the consent of the other owners.

4.2 Antitrust Regulations

A prospective purchaser must be aware of the applicable antitrust regulations. These can apply to the acquisition of an entire enterprise or to the acquisition of only a partial interest in one. There is either a notification or a registration requirement. The acquisition of all of the assets of the enterprise or of an essential part of them is subject at least to compliance with the applicable notification provisions. The acquisition of shares of stock or equity holdings of a company is subject to such notification compliance if the ownership interests in question together with any interests already owned constitute a prescribed percentage of the voting stock or holdings. It can be as low as 25%. However, the duty of notification is triggered only if the combined firms have at least a 20% market share or € 500 million in yearly sales.

In satisfying the notification requirements, the Federal Cartel Authority (“Bundeskartellamt”) must be notified immediately after the sale. If the Federal Cartel Authority subsequently determines that the sale violates market control provisions (and determines that the acquisition does not qualify for an exception), it can prohibit the transaction within 1 year after the sale, and in such a case it will allow the parties an appropriate period of time to undo the transaction. If a sale of ownership interests or assets must comply with the more burdensome registration requirements of the Federal Cartel Authority, registration must occur prior to the closing of the sale. The Federal Cartel authority then has a period of 4 months in which to prohibit the transfer. The antitrust regulations must be examined closely on a case-by-case basis.

4.3 *European Community Regulations*

The non-European purchaser must realize that the European Economic Community Treaty contains its own antitrust regulations and that ordinances and decisions of the Council and the Commission can be directly binding on individual parties within the Member States (see chapter “Institutions of the EC”).

5 Special Considerations for Foreign Purchasers

5.1 *No Basic Restrictions*

Basically, there are no restrictions on the acquisition of German companies by foreign purchasers. The transfer of assets or the acquisition of ownership interests by foreign investors can be prohibited only when this is necessary to protect the national interest, which is, for example, the case when armament control is involved. An acquisition can also be prohibited if an attempt is made to use it as a means of circumventing restrictions on the employment of foreigners not holding German residence permits.

5.2 *Transfer of Shares and Assets*

German international property law does not permit a choice of law as to the actual transfer of property, whether it is personal property or real estate. The transfer of a German company through the sale of assets or ownership interests must, therefore, take place in accordance with German law. The acquisition of ownership rights in German companies by foreigners is furthermore subject to the company’s own articles of incorporation, which are governed by local laws. Thus, it is necessary to ascertain whether a stockholder or owner agreement or the corporate charter imposes any prohibitions.

6 Conclusion

The German civil-law system offers potential business purchasers considerably more protection than the Anglo-American common-law system. They are, nonetheless, well advised to seek a well thought out written agreement, which will enable them to make more informed business decisions and help them avoid future conflicts. This chapter does not contain a complete description of all the legal and tax issues that might arise in the acquisition of a company. Prospective purchasers are emphatically advised to rely on their own attorneys and tax consultants when preparing to make

such a complicated transaction. Although as a general rule it is always highly advisable to seek professional, individual help before acting on any decisions that could be of considerable economic impact, this is particularly true in any issues involving taxes. German tax laws are constantly being revised. Therefore, it is essential that the current validity of the information presented here be verified, modified or adapted to a particular case by professionals who are abreast of the developments in the German tax-law arena before any binding commitments are made on the basis of it.

Acquisition-Agreement Checklist

Below, in the form of a checklist, are the essential issues which should be negotiated and included in an acquisition contract:

(1) Parties

- Including authorized representatives and persons with full powers of attorney

(2) Preamble

- Motives and basis of the transaction

(3) Object of sale

- Acquisition of shares or assets
- Purchase of shares: special clause for the transition of loan accounts
- Sole proprietorships/partnerships: special clause for the transition of special equities. Reference to balance sheet and/or itemized listing of assets (indispensable when the object of sale is a part of the business)
- Due diligence
- Special consideration: seller's right to withdraw capital to the date of closure
- Special consideration: seller's obligation to balance losses shown in the cash accounts or special accounts

(4) Assumption of liabilities

- Acquisition of shares in the business: no specifications
- Acquisition of an enterprise: regulation of liabilities to the date of closure
- Acquisition of part of an enterprise: categorized itemization of assets
- Right of indemnity for non-assumed liabilities

(5) Transition of employee relationships

- Enterprise as a whole: no specification required. Automatic regulation by Par. 613a BGB. Right of rescission potentially possible in the event of employee objections
- Part of an enterprise: itemized categorization of employee relationships

(6) Pension obligations

- Internal division of the pension obligations (no effect on employees)
- Transfer of support obligations to an independent relief fund

- Seller's termination obligation prior to transition
- Any hiring of new employees prior to closure requires purchaser approval

(7) Current contracts

- Purchaser approval
- Rights of indemnity

(8) Personal securities

(9) Unanticipated liabilities

- Warranty that all liabilities are included in the balance sheet
- Division of risk: obligation to indemnify, reduction of purchase price, set-off claims

(10) Further declarations and regulations regarding:

- Contracts with advisors
- Division of sales and profits
- Security rights
- Long-term delivery contracts
- Pending transactions (division of future profits and losses)
- Approved cartels
- Currently existing non-competition agreements
- Currently existing powers of attorney
- Legal disputes

(11) Permits under public law

- Warranty that the assets of the firm are unencumbered and its operations unendangered

(12) Prohibition of competition

- Scope in terms of content, time and place

(13) Determination of purchase price

- Determination criteria
- Basis for the determination of book values
- Quota-share regulation in the case of partial purchases
- Differences based on increase/reduction of current assets or short-term accounts receivable/accounts payable up to closure
- Right of indemnity for later payments decreasing the value of the firm, e.g., taxes
- Balance at transition: cooperation duties, valuation criteria, choice of CPAs including arbitrator

(14) Warranties

- Completeness of all information provided
- Correctness of statements according to the best of knowledge

- Balance: continuation of current practices, no incurring of new liabilities
- Sales and profits: express assurance is necessary to hold the seller liable
- Exclusion of any rights to rescission
- Reversal of transaction: maximum liability, secrecy obligations

(15) Actual transition

- Exact point in time
- Method of transition (physical, assignment, transfer of trademarks, obtaining of records, etc.)
- Assurance that no essential changes have taken place between the time of contract and sale
- Methods of payment of the purchase price
- Purchaser's obligation to close (provided no essential changes have occurred and all pre-agreed conditions have been fulfilled)

(16) General regulations

- Duties of disclosure after sale
- Assurance that no illegal antitrust agreements exist
- Right to purchase further stock or equity holdings in the enterprise
- Choice of law
- Assumption of expenses (attorney, notary, commercial register, real-estate register)
- Division of taxes
- Jurisdiction
- Rescue clause

(17) In the case of antitrust notification requirements:

- Receipt of permission as a condition for suspension

(18) Statute of limitations

- For warranty claims
- For tax indemnity claims

(19) Arbitration clause

Valuation of Business Enterprises

B. Tremml

1 General Information

The purchase of a business enterprise or shares of stock generally does not occur until the value of the business has been appraised. The question as to what method should be used in determining the value of a business enterprise was vehemently disputed in Germany for a long time.

The traditional valuation method, known as the “Stuttgart Procedure” (“Stuttgarter Verfahren”, has fallen out of use, except for specific tax purposes, primarily in property and inheritance tax law. This method basically consists of determining the capitalized value of potential yield (productive or earning value) and the tangible value. The development of this procedure was heavily influenced by the post World War II economic climate, in which valuations gave great weight to existing tangible assets of the business, but rated the “productive value” of the enterprise solely on past results. On the whole, the Stuttgart Procedure ordinarily provides very low and inaccurate valuations of commercial enterprises, and is now only an acceptable method of valuation for tax purposes.

Due to the unsuitability of the Stuttgart Procedure, valuation procedures were developed that emphasized operational economic considerations. The controversy over which method of valuation engendered by these so-called “practical procedures” has been apparently resolved. The most substantial contribution in this direction was provided by the publication of the opinion of the Institution of Certified Public Accountants in 1983, regarding the basic means of conducting a valuation of business enterprises. The premise became established that the productive value of a business enterprise is the sole relevant value, that a business enterprise is worth only as much as the future withdrawable profits. In determining this productive value, the tangible value has only a supportive function.

In the valuation procedure, the local statutory and tax law framework play an important role. However, before entering into a valuation contract the potential purchaser must realize that the valuation will be influenced by the purchaser’s own subjective value perceptions, and that the final price will not be completely determined by rational factors.

2 The Productive Value of the Business Enterprise

2.1 *Problems and Principles of Appraising Productive Value*

1. The value of a business enterprise is equal to the cash value of its future net profits. In theory, that value is comprised only of the surplus earnings that can be permanently withdrawn without causing harm to its production value. In actual practice, however, this pure theory has to be considerably modified.

For example, commercial law restricts the formal premises upon which a profit-distribution decision according to commercial law regulations and on the basis of strict accounting. Due to such restrictions, a situation can arise where surplus profits exist, but not being simultaneously distributable, are not considered in this type of valuation. Therefore, it is essential to make additional assumptions concerning the future profit-distribution performance of the business.

2. However, when the distributable profit is used as a guideline, the problem of the time placement of future yields arises. Such yields should be properly assigned to the periods of time for which they are anticipated. Of course, the further into the future the appraiser's projections are made, the less accurate they become. The appraiser should, therefore, weigh the projected yields for each future period of time so that their value on the key date will progressively diminish, the further away from this key date the projections are made.
3. This problem applies to the accuracy of predictions in general. Since the uncertainty of expected profit flow leads to various predictions, it is necessary to weigh the probability of each of the projections individually.
4. The amount of future distributable profits must include a deduction of the possible interest that could have accrued as of the key date, had the funds been invested differently.

The internal interest rate (profitability) of an investment alternative is used to establish the rate of interest that ought to be deducted from all future yields. In other words, the future business profits are compared with the expected surpluses of an investment alternative. In determining this interest rate, the appraiser will ordinarily refer to the on-going domestic interest rate for long-term investments in the capital market. In the Federal Republic of Germany, it is common practice to use, as an orientation, the reports on investment returns on fixed, interest-bearing securities ("Umlaufrenditen") publicized by the Federal Reserve Bank of Germany ("Deutsche Bundesbank").

In some cases, depending on the purpose of the valuation (see the above delineation as to how careful the projected earnings are to be figured), it will be necessary to add a risk figure to the affixed interest rate. It is a matter of controversy whether the interest rate should be "inflation purified" as well. Normally, however, the inflation situation and inflation expectations have already influenced the capital market interest rate, and further inflation purification would therefore be superfluous. If the interest is "inflation purified", however, this

should have occurred before any risk factor was added, since the result would otherwise include an “inflated risk.”

5. The business enterprise must be valued in terms of its total function. This aspect is of particular importance to the mixed and affiliated enterprises frequently found in the Federal Republic of Germany (“GmbH & Co. KG,” divided enterprises, joint-stock companies and silent partnerships), which are generally formed predominately for tax purposes. Experience has proven that it is extremely difficult to trace such divided enterprises back to a uniform object of appraisal. Furthermore, because such mixed businesses so frequently fail due to collisions with commercial or tax laws, statements concerning their valuation can be made only on a single-case basis.
6. The complaint is frequently made that the net worth of German enterprises is too low. If the total net worth is outside the currently common range, the appraiser should use empirical values (such as the common net worth of other enterprises within the same branch of business or the reasonable and proportionate amount of borrowed capital) to figure the total value of the corporation on the basis of normalized finance structures.
7. The possibilities of alteration to the enterprise which are open to the purchaser are generally not to be taken into consideration. Whether or not the valuation includes the future measures contained in the seller’s plans depends on the purpose of the evaluation. In general, such proposals are taken into consideration only insofar as preparatory measures have already been initiated and implemented (e.g., the results of research and development projects or investments in equipment).
8. A past analysis should always provide the basis for appraising the future earning capacity, but not, in the sense of determining a “yield sequence” that can be extrapolated into the future. Instead, the past results should be purified for extraordinary fluctuations or any infringements of accounting and valuation principles (including infringement of the principle of determining results properly according to time periods). Only then will it be possible for the appraiser to recognize the course of development and, proceeding on the basis of past development, to predict future turnover, draw up an investment plan, estimate the depreciation requirements and make a projection of the interest burden.
9. As already mentioned above, the tangible value of the enterprise is relevant only as the intermediate value of the business transformation process. In this regard, it simply represents previous expenditures and has merely an auxiliary function in figuring the productive or earning value of the business enterprise. As such, it is the essential object of reference in determining the amount of operating capital and the financial resources that will be required in the future in regard to all productive-value items that depend upon the tangible value. It is also indispensable as a foundation for investment planning (reinvestments!).
10. Personnel related value factors (for example, the personal qualifications of the management staff) definitely play an important role for the purchaser. It is

questionable whether such factors should be included in a computed business appraisal since, in such a case, it is not possible to arrive at anything more than very rough estimates. In the case of unincorporated firms or enterprises that are owned, operated and driven by individuals on the equity of their own names, it is both possible and necessary to affix a value to that equity and to do so, irrespective of whether or not the investor plans to continue the business in its previous legal form.

2.2 Guidelines for Determining Productive Value

2.2.1 Purification of Past Values

The last three to five fiscal years should be considered and any non-essential operational assets should be eliminated. Expenditures and earnings should be assigned to the time periods in which they occurred. There will be some necessary modifications such as depreciation on the basis of repurchasing costs, purification of extraordinary influencing factors and the ensuing changes (especially any changes relating to interest and tax expenditures).

2.2.2 Analysis of Earning Capacity

Once the purified past results are available, a quantity framework should be made on the basis of them. If it is to be successfully used for future planning, it must include the following elements:

- Prediction of sales
- Investment plan and projection of write-off requirements (age structure of production equipment, any repurchasing costs)
- Calculation of financing needs and projection of interest burden (non-operational expenditures)
- Projection of results within the sector of essential operational assets
- Consideration of personnel factors
- Separate valuation of non-essential operational assets

Prediction of tax expenditures: this requires a supplementary calculation for determining the expected tax advantages.

“Pseudo – Foreign Companies” in Germany – The Centros, Überseering and Inspire Art Decisions of the European Court of Justice

K.F. Sturfels

1 Introduction

Barriers to doing business across borders erode in the European Union. The decisions of the European Court of Justice (thereafter “ECJ”) illustrate the tenuous place which the idea of regulatory competition currently occupies in the EU legal order. The ECJ in *Centros*, *Überseering* and in *Inspire Art* have changed the business landscape by opening up Europe to legislative competition in corporate law. The Court held that a company’s legal personality and its capacity to be a party to legal proceedings must be respected all over Europe. Companies can now be found in a Member State without having later any further relations to it, this having been a central obstacle to legislative competition in the past.

As a consequence of the Court’s judgments, an English Limited Company operating entirely in Germany must now be recognized as such, and only the laws of the state of incorporation, i.e. British law, will govern its corporate existence and administration. As a result, some think that an English company in an acquisition and financing of a German business may prove an attractive option for foreign investors. The Court’s rulings may pave the way to avoid certain issues that may arise out of mandatory provisions of some European continental company laws which may not be desirable.

2 Facts of the Cases

More than 10 years after the implementation of the European Single Market, corporate law in the European Union (EU) still varies greatly from one Member State to the next.

The process of harmonization of corporate law in the European Community has to be seen in relation to the right of establishment of companies (Art. 43, 48 EC). The ECJ has described the right of establishment as a “fundamental right” (Case C-81/87, *R. v. HM Treasury and Commissioners of Inland Revenue, ex p. Daily Mail and General Trust Plc* [1988] E.C.R. 5483, para 15). However, Art. 43 EC

provides that “within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited.” Article 43 goes on to say that “freedom of establishment shall include the right to take up and pursue activities as a self-employed person ... under the conditions laid down for its own nationals by the law of the country where such establishment is effected”. Thus a company formed in accordance with the law of a Member State is entitled to exercise the right of establishment if it has either its registered office, its central administration, or its principal place of business within the Community.

However, in the past, diversity in the laws of the individual Member States has survived attempts at harmonization, enabling the Member States to experiment in their search for efficient and workable rules of company law. The possibility of a market for incorporations has been blocked by the operation of national-level rules of the conflict of laws limiting the degree to which a company can choose its applicable law. Problems arise from the incompatibility of the two major theories linking a company to a system of law. A change or a primary establishment involving a transfer of company headquarters or central management may be hindered by national legal provisions to the effect that a company transferring its executive offices out of the jurisdiction loses its corporate personality or that a company wishing to establish its executive offices within the jurisdiction must be newly constituted there.

Member states within the EU are divided into two lines of thought concerning the conflict of law legislation. A number of states, including the Netherlands, the UK, Ireland, and Denmark subscribe to the incorporation theory, while in the case of the remaining states the real seat theory prevails.

Pursuant to the incorporation theory, the internal affairs of a corporation are governed solely by the laws of the state in which it was formally incorporated. This theory will recognize any corporation that has been lawfully incorporated within another Member State’s jurisdiction, regardless of where the company locates its principle place of business. Therefore, a company can carry on business in one Member State while being incorporated in another.

In contrast, Member States following the real seat theory require the internal affairs of a corporation to be governed by the laws of the state in which the company has placed its “real seat.” In other words, this theory will not recognize a company as a legal entity and treat it like something which does not have any legal personality and, in consequence, as something which no longer possesses limited liability, unless the company’s real seat is located in the same jurisdiction as its place of incorporation. Therefore, under this theory, a company that transfers its real seat will not be recognized unless it reincorporates within the jurisdiction to which it has moved. The reason is that, because the company has not incorporated according to the rules of real seat jurisdiction, it does not exist according to the law of that jurisdiction. A change in governing Member State law cannot be accomplished without winding up or liquidating the business first. Clearly, this procedural requirement places a severe restriction on the movement of corporations and may amount to a denial of that company’s right of establishment.

The catalyst for changes has been the Centros decision of the ECJ (Case C-212/97 *Centros v. Erhvervs- og Selskabsstyrelsen* [1999] ECR-I 1459). In Centros, the ECJ has begun to vitiate the real seat rule by reducing barriers to cross-border transactions.

Thus, in the Centros case, a Danish married couple resident in Denmark formed a limited liability company in England whose only business activities would be carried out by a branch in Denmark (“Centros”). The share capital of Centros was £ 100, and the sole reason the Danish nationals set up a company in the UK rather than Denmark, was to secure the advantages of limited liability without having to meet the costs of the £ 20,000 minimum capital requirement then prevailing in Denmark. Under Danish law, foreign companies were entitled to do so, but the Danish authorities refused to register the Centros branch on the ground that Centros did not trade in the UK, and its creation was simply a device to get around the particular rule of Danish company law concerning the minimum paid up capital of limited liability companies.

Referring to previous cases involving abuse of Community law, the ECJ then commented that the very purpose of the Treaty is to allow companies to set up subsidiaries and branches throughout the Community. The Court confirmed that a company formed in one Member State, for the sole purpose of establishing itself in another, where its main or even sole business activities were to be carried on, could rely on the right of establishment, and added that the fact that the company was set up by nationals of the latter Member State resident in that State for the sole purpose of avoiding the minimum capital requirements of that State was immaterial. The Court held that the refusal in such circumstance of the national authorities of the State in which the branch was to be formed to register that branch amounted to an infringement of the right of establishment, which could not be justified by mandatory requirements in the public interest, or on the ground of improper circumvention of national rules. Accordingly, the fact that a national of a Member State had chosen to form a company in the Member State whose company law was the least restrictive could not be regarded as an abuse of the right of establishment.

In its most recent judicature, the ECJ continued its tendency of deciding in favour of the freedom of establishment by holding that rules submitting “pseudo-foreign companies” to the company law of the host state were not allowed.

In 2002, the ECJ was confronted in a preliminary ruling from the German Federal Supreme Court in the *Überseering* case (Case C-208/00, *Überseering BV v Nordic Construction Co Baumanagement GmbH* [2002] E.C.R. I-9919). *Überseering BV*. In *Überseering*, a Dutch corporation registered in the Netherlands – and NCC – a German company – concluded a contract. *Überseering* moved its central management and control to Germany. Later *Überseering* sued NCC for damages. Due to the fact that the real seat of *Überseering* had been moved to Germany, German courts denied the legal capacity of *Überseering*.

The ECJ held that the legal capacity of a company that was formed in accordance with the law of a Member State in which it has its registered office and which exercises its freedom of establishment in another Member State has to be recognized by that Member State.

With the judgement in *Überseering*, the ECJ has given the right of establishment a radically new, wider interpretation. Due to the Court's displayed, wider understanding of the right of establishment, companies can now be found in a Member State without having later any further relations to it, this having been a central obstacle to legislative competition in the past.

In *Inspire Art* (Case C-167/01, Judgement 30/09/2003, *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd*) the ECJ decided again clearly in favour of the freedom of establishment.

Inspire Art Ltd. was established in the UK. Immediately after its formation, the company started doing business in the Netherlands, where its sole shareholder and director was domiciled. No business was to be conducted in the UK. In fact, from the very beginning the shareholder only intended to take advantage of the liberal rules of UK company law. A branch of the company was registered in the commercial register of the Amsterdam Chamber of Commerce without the indication that *Inspire Art* was a pseudo-foreign company. As a pseudo-foreign company, *Inspire Art Ltd.* would have been obliged to comply with the provisions of Article 2–5 WFBV (*Wet op de formeel buitenlandse vennootschappen (WFBV)* (Dutch law on pseudo foreign companies)) which de facto stipulated a minimum capital. The Dutch court held in its decision that *Inspire Art Ltd.* was a pseudo-foreign company within the meaning of Article 1 WFBV and referred to the ECJ questions for a preliminary ruling.

The ECJ ruled that Article 1 WFBV, stating that Dutch branches of pseudo-foreign companies must disclose the fact that they are pseudo-foreign companies, was in breach of the 11th directive, because the latter did not permit any disclosure rules going beyond the rules contained in it. The Court held that a requirement corresponding to the Dutch provision could be found neither in the list of the obligatory nor of the facultative disclosure requirements and was therefore inadmissible.

Further, the ECJ referred to its earlier judicature and held, except in cases of fraud, that it was immaterial for the applicability of the freedom of establishment that a company had been set up in a certain Member State with the sole aim of establishing itself in another Member State, where its main or indeed entire business was to be conducted. It also held that it did not constitute an abuse to choose a jurisdiction only for its liberal rules, and whether or not Member States could prevent the abusive reliance on Community law in spite of that was a different question.

The Court decided that the provision which requires pseudo-foreign companies to have capital at least equivalent to the minimum capital prescribed for Dutch companies with limited liability in order to exclude the personal liability of their directors, constituted a violation of the freedom of establishment in any case. Such a provision could not be justified by an imperative requirement in the public interest because neither Art. 46 EC nor the protection of creditors, the prevention of an improper recourse to freedom of establishment, the enforcement of fairness in business dealings nor the efficiency of tax inspections could be invoked in this case. The Court pointed out that *Inspire Art Ltd.* held itself out to be a foreign and not a Dutch company and, therefore, its creditors were sufficiently informed.

With Inspire Art, the ECJ has widely opened the door for corporate restructuring within European company law, increasing the competition among the legal systems. In *Überseering*, the Court held that a company’s legal personality and its capacity to be a party to legal proceedings must be respected all over Europe. In *Inspire Art*, the ECJ extends this obligation to the entire legal system of the state of incorporation.

3 Advantages and Disadvantages

In comparing business entities, some are of the opinion that an English Ltd offers higher flexibility than German legal forms. Also, for reasons of time and economy (as far as the expenses for formation, the assignment of shares and initial capital are concerned) the Ltd seems to be a favorable alternative.

For example, by selecting a non-German company form, business can now be done in Germany without having to adhere to the German rules on co-determination. The German co-determination rules have been perceived by investors as particularly cumbersome when it comes to reorganizations and corporate restructurings. Further, the strict rules on capital maintenance may not apply. German capital maintenance rules strictly prohibit financing structures that could lead to a repayment of the stated share capital.

On the other hand, there are some reasons to doubt whether it is advisable to use a foreign legal entity in Germany. Even with strong legal guarantees of free movement, linguistic, cultural and other practical barriers to movement on the part of people and organizations could be expected to persist. Related to this problem, the differing legal systems existing within the EU, i.e. common law system versus civil law system, procedural differences between courts of Member States, the uncertainty concerning conflict of laws within the EU and additional costs of specialized judicial expertise and advice in taxation may also discourage potential re-incorporations.

4 Future Prospects and the Reform of the Law on Limited Liability Companies

The possible emerging competition of national corporate laws in the aftermath of the Court’s *Centros*, *Überseering* and *Inspire Art* decisions might lead to more innovation and experimentation in the legislative processes of the Member States, giving investors great flexibility by enabling them to select the legal structure for their companies that best suits their needs.

The German Government has issued a draft proposal for a reform of the law on limited liability Companies (*Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen*) having two objectives. One is to maintain the GmbH

structure's status as an attractive business vehicle against increasing competition from other corporate forms in the EU, and the second is to increase protection against abuses of the GmbH structure. The new act will probably enter into force in the first half of 2008. The most important amendments are in the following.

The statutory minimum capital will be reduced from €25,000 to €10,000, of which €5,000 must actually be raised. The necessary documentation relating to the formation of a GmbH will have to be filed electronically with the commercial register. Moreover, the new legal regime will provide for a bona fide acquisition of shares. The proposal allows a purchaser to rely on the list of shareholders if no objection has been raised to an incorrect entry on the list for 3 years. The proposal also allows the GmbH to relocate its seat to a jurisdiction different to that of its registered office.

Part II
Commercial Law

The Law of Contracts

M. Luber

1 Introduction

The basic principle of freedom of contract is applicable here as the most distinguishing feature of private autonomy. All citizens have the right to enter into contracts for any legal purpose they desire. The German Civil Code (BGB) offers certain standard types of contracts to choose from, but also grants the freedom to create entirely new contracts. What constitutes the basis of a contractual relationship as well as the reason for its coming into being, is the voluntary decision of the parties to assume certain obligations as they so define.

As opposed to the above, purely statutory relationships under the law of obligations – settlement of a third party’s legal obligations without a contract (*Geschäftsführung ohne Auftrag*) and obligations stemming from unlawful conduct (*unerlaubte Handlung*) or from undue benefit (*ungerechtfertigte Bereicherung*) – come into being by the force of law and not through the willful effort of the parties.

Favors by their very nature do not contain any legal obligation. One-sided agreements on the basis of friendship, neighborliness or helpfulness among coworkers normally do not constitute any legal obligation to provide a counter-performance. Such cases are characterized precisely by the lack of intention to enter into a contractual relationship.

However, German law recognizes contracts that do not require any performance obligation but instead contain the right to exercise a certain legal right. The transfer of ownership of material goods and the assignment of rights have their own contractual form, the so-called real contract, (*dinglicher Vertrag*) as opposed to the obligatory contract (*schuldrechtlicher Vertrag*). The real contract exists parallel to and independent of the obligatory contract (abstraction principle, or *Abstraktionsprinzip*). If the purchase contract should prove to be invalid, that would not necessarily mean that the contract regulating the transfer of ownership would also automatically be invalid.

A large part of German contract law is regulated in the Civil Code (BGB). A major reform in 2002 not only considerably modified the laws governing irregularities in the performance of contractual obligations and the statute of limitations in regard to claims, but also integrated several separate legal acts into the BGB, the most important of which are the consumer protection laws. Other legal sources of laws governing

contracts are the Commercial Code (*Handelsgesetzbuch*) and special laws such as the Insurance Act (*Versicherungsvertragsgesetz*). Despite this statutory foundation, case law, created by judicial decisions, plays a very significant role. Numerous legal issues arise in daily legal practice that can be resolved only by analyzing the court decisions that have been made in precedent cases.

2 The Coming into Being of Contracts

2.1 Offer and Acceptance

Every contract is based on an agreement of intention, which is expressed in the conclusion of the contract. This normally takes place in the form of a preceding offer and its acceptance. In joint contract negotiations, on the other hand, the conclusion of the agreement is based on the mutual declaration to accept the results of the negotiation, and the contract comes into being, even if it is not possible to identify the existence of an offer and the acceptance of it.

The offer must be so precise and comprehensive that it can be accepted with a simple “yes”. As opposed to Anglo-American law, the offer is binding as a general rule and cannot be withdrawn unless the right to do so has been expressly reserved. Acceptance does not have to be declared out right, but can also be deduced from clearly indicative behavior such as a nodding of the head. The other party to the contract can even entirely waive having acceptance of its offer expressly declared, as is the case in mail orders and written hotel reservations.

Contracts can also be concluded by representatives. As in Anglo-American law, German law permits direct representation if and when the representative is clearly acting as a proxy and possesses the necessary authorization to do so. If either of these prerequisites is lacking, the contract comes into being with the representative himself.

2.2 No Need to Provide Consideration

As opposed to Anglo-American law, German law does not make the validity of a contract dependent upon consideration being offered in return for a performance. On the contrary, it also recognizes contracts of one-sided obligations such as gifts and donations and sureties (*Bürgschaften*). However, in such cases the BGB proceeds from a recognition of a special need to provide protection to the debtor and, thus, requires a special form for such contracts that can go as far as compulsory notarization. In that way, German law essentially fulfills the same objectives as the institution of consideration does in Anglo-American law. Its requirements are comparable to the former common law practice of “contracts under seal.”

2.3 Conclusion of Contracts That Incorporate Standard Terms of Business (*Allgemeine Geschäftsbedingungen, or AGBs*)

Whenever one party to a contract has to deal with regularly recurring contracts of the same order, it strives to standardize its terms of contract to avoid having to negotiate every contractual stipulation every time it makes a transaction. That way contract negotiations can be focused on the main performance obligations and on liability issues, while the remaining terms of contract can be presented by one of the parties in the form of AGBs. This, however, is possible only under restricted circumstances, since AGBs are subject to very strict legal control. Hence, simplification is gained at the price of stricter control (for more details see the chapter “General Terms of Business (AGBs)”.)

2.4 Obligation to Enter into Contracts (*Kontrahierungszwang*), Contracts in Fact

As a general rule, every contract is based on the principle of mutual voluntary decision to enter into contractual obligations. In certain cases, however, there exists the obligation to conclude a contract that has been laid out by another party (*Kontrahierungszwang*). This is the case in the provision of electricity and gas, postal services and liability insurance for automobiles. Judicial decisions have furthermore recognized an obligation to enter into contracts based on the anti-trust laws contained in the Act Prohibiting Restrictions of Competition (*Gesetz gegen Wettbewerbsbeschränkungen, or GWB*). They force companies that dominate the market or which have a very strong market presence to conclude agreements with other companies, whenever the refusal to enter into the contracts in question would constitute a violation of the prohibition of discrimination. Last but not least, public bids also force the government to enter into contracts with the bidder offering the best price.

Labor law and corporate law furthermore recognize that a void contract cannot be retrograded once it has been fulfilled. The parties to the contract are thus dealt with in the same way they would be treated if the contract had been valid in the past, which rules out restitution for any obligations already performed.

2.5 Special Regulations Governing Contracts with Consumers

As a matter of legal principle, once a contract has been concluded the parties are bound to it and obliged to fulfill the agreements they have made. In the case of contracts with consumers, however, the law provides special powers of revocation under certain circumstances, which allow consumers to back out of the contract and

thereby dissolve the contractual relationship with all of its obligations. Companies, therefore, cannot depend on the validity of a contract with a consumer until after the deadline for revocation has elapsed, which generally amounts to 2 weeks.

Consumers are granted the power of revocation in the following types of business transactions:

- Door-to-door sales
- Long-distance sales
- Loans
- Delivery-by-installment contracts
- Time-sharing contracts
- Correspondence courses (long-distance learning contracts)

“Door-to-door sales” in the legal sense include any kind of sale that occurs when the consumer is taken off guard in his residence, at his workplace or in a public location and is pressured into signing a contract. It is the circumstance of the consumer’s being taken completely off guard that is the main causative factor of his right to retract the contract.

Long-distance sales are characterized by the lack of personal contact between the contracting parties. The contract comes into being exclusively through the use of the instruments of long-distance communication, such as telephone, fax, letters, e-mail or the internet, whereby the provider systematically uses such instruments for concluding contracts. The lack of personal contact between the parties and of any possibility to examine the object of the contract are the main reasons why the right to retract the contract is granted to the consumer in this case.

In contracts for items that are to be delivered in installments, the performance obligations are not fulfilled at once but rather in several partial deliveries over a period of time. Accordingly, the consumer has to offer several counter-performances. The law grants him the power to revoke the contract in order to protect him against having to repeatedly fulfill obligations, the full extent of which may not have been grasped at the time the contract was concluded.

2.6 The General Equal Treatment Act

The General Equal Treatment Act (AGG) – also known as anti-discrimination law – has been in force since 2006 and aims to prevent the undue disadvantage on the grounds of race, ethnic origin, sex, religion, personal disability, age or sexual identity. If an unjustified discrimination occurs, the disadvantaged person has several claims, especially damage claims. It is important to know that these damage claims have to be raised within a period of 2 months after the discrimination.

In the field of civil obligations, entering and terminating contracts, are subject to the general equal treatment act. Nevertheless, the AGG is only applicable to contracts that are used in numerous cases with comparable conditions and irrespective of the other person (so called mass deals).

2.7 Void Contracts

Even a successfully concluded contract can ultimately prove to be worth nothing if it is revoked (see above) or if it is void. The major causes of contractual invalidity are non-compliance with legal form, lack of intention and violations of legal prohibitions.

2.8 Non-Compliance with Legal Form

As a matter of principle, contracts under German law can be concluded with no particular form. That simplifies legal transactions and does justice to the circumstances of modern business. In some cases, however, the law does require a specific form in order to prevent the parties from rushing into binding agreements without due consideration of the consequences, to make sure they have the possibility of receiving adequate advance counseling and to create substantial proof of the details of the agreement. This special form generally consists of a written version of the contract or of a notarized deed. If the contract does not comply with the legal form requirements, it is null and void. If the contract is nonetheless fulfilled, its non-compliance is frequently cured and the contract becomes valid after the fact.

Notarized deeds are required by law mainly in real-estate transactions, inheritances and family law matters, as well as whenever changes are to be made in the legal form of companies. Written form is required for long-term rental contracts, consumer loans and collateral sureties.

The Anglo-American statute of frauds occasionally goes further than German law with regard to form requirements. Such is the case, for example, with sales contracts that exceed a certain amount, and under Anglo-American law must be drawn up in written form.

The parties themselves can also agree that any contractual supplements or modifications have to be in writing in order to be valid. That stipulation can be lifted implicitly, however, which means that it rarely has a binding effect.

2.9 Lack of Intention

A contract is also void if one of the parties did not properly and adequately form its intention to conclude the contract. In this case, the party concerned can contest the contract and is no longer bound to its obligations.

A deficiency of intention exists particularly when the party concerned was mistaken about essential characteristics of the object of the contract or when it was fraudulently deceived by the other party. In such cases, in which the declaration given does not correspond with the person's actual intent, the law provides for dissolution of the contract.

2.10 Statutory Prohibitions

The principle of freedom of contract, which is to say, the right to enter into contracts with any conceivable content for the purpose of shaping one's own lifestyle, inherently contains the risk of abuse. It is not feasible, however, to conclusively codify and specifically prohibit all the multifarious possibilities for abuse. German law has thus created two general clauses for the prevention of the abuse of the freedom of contract: the contract is void if it is either illegal or immoral.

Statutory prohibitions are not at the parties' disposition, which is to say that no one has the power to surpass any normative laws by way of mutual agreement. Prohibitive laws are any laws that prevent the contract from materializing on the basis of its content or because of the circumstances under which it was concluded. In most cases they are either criminal laws or consumer protection laws. A contract for a drug deal is void due to its criminal content, whereas a contract that was forced upon a person under duress is invalid due to the circumstances under which it was concluded.

German courts have consistently held that a legal transaction is immoral whenever it contravenes the "sense of decency of people thinking equitably and justly," or the commonly recognized moral values of the community as a whole. In determining what constitutes the latter, the judiciary pays just as little attention to extraordinarily rigorous viewpoints as it does to extremely liberal ones. Its primary concern is to protect the socio-ethical minimum, without which the legal community could not continue to exist. It is thus immoral, for example, to engage in commercial trading of human organs.

A usurious contract is also immoral. Such a contract exists whenever one of the parties to it exploits the circumstantial necessity, the inexperience or the considerably weak willpower of the other party for an incommensurate consideration for a certain performance.

2.10.1 Culpa in Contrahendo

If a contract does not materialize or if it proves to be invalid, there normally do not exist any further consequences for the parties to it. By way of exception, however, liability for damages can exist on the basis of culpa in contrahendo. The initiation of contractual negotiations itself can give way to a relationship of mutual trust that obliges both parties to be considerate of the other's interests. Therefore, it is recognized that the breaking off of negotiations without reason or the negligent causation of a void contract gives rise to liability for damages.

As a general rule, the parties are free in making their decisions before the contract has been finalized and, thus, have the right to break off negotiations at any time. However, neither of the parties can do so without good reason once they have explicitly aroused the other party's trust and confidence that the contract will materialize.

Good reason is lacking particularly whenever negotiations are discontinued for discriminating reasons irrelevant to the matter at hand.

The negligent causation of a void contract likewise gives rise to liability for damage compensation whenever the obstacle preventing materialization of the contract lies within the sphere of influence and the area of responsibility of one of the parties. That can be the case, for instance, if the leader of the negotiations does not possess the necessary power of representation or if immoral stipulations have been imbedded in the contract.

3 Irregularities in the Fulfillment of Contracts

The content of any and all contracts is the obligation of the debtor to perform the stipulated obligation and, thereby, fulfill the corresponding claim of the creditor. If that obligation is not fulfilled at all or not fulfilled the way it ought to be or not fulfilled on time, there is an irregularity in the fulfillment of the contract. The regulations that come into play whenever such a breach of obligation occurs and determine the subsequent legal consequences comprise what is called the “law of irregularities in performance” (*Recht der Leistungstörungen*). Furthermore, every contract contains unwritten behavioral obligations that hold the parties responsible for taking due consideration of the other party’s interests and insuring their protection. A breach of such obligations can result in liability for damages.

An irregularity in the fulfillment of a contract can also occur if the creditor refuses to accept the performance duly offered.

3.1 Non-Fulfillment of Contract

Non-fulfillment of contract exists whenever the debtor makes no effort whatsoever to perform his contractual obligations. There can be various reasons for that: the fulfillment can be objectively impossible, it can demand too much effort or expense or it can be that the debtor does not have access to the personal or material resources necessary to fulfill the obligation.

Whenever fulfillment of a contract is objectively impossible, the performance obligations are automatically nullified. The creditor can then demand compensation for damages if the non-fulfillment is imputable to the debtor; that is, if the impossibility of fulfillment is due to circumstances that lie within the debtor’s range of responsibility.

In the other two instances the creditor has to set the debtor a reasonable deadline for fulfillment. Once the grace period has elapsed, he can avoid the contract and demand damages for non-fulfillment, provided, in this case as well, that the non-fulfillment of contract is imputable to the debtor.

3.2 *Insufficient Performance*

In contrast to complete and total non-fulfillment, insufficient performance means that the contract has indeed been fulfilled, but with lesser quality than that which was agreed to. Typically this involves deliveries of faulty goods or the performance of inadequate service. The Civil Code first grants the creditor a claim to have the matter remedied and, only if that fails to end in proper fulfillment of the contract, a revocation of the contract is possible.

3.3 *Delay*

The debtor is in delay with the performance of an obligation if he does not fulfill it within the timeframe agreed to in the contract. The performance obligations of the debtor nonetheless remain intact. The creditor can notify the debtor and set a final deadline for fulfillment, after the elapse of which he can avoid the contract and demand damages due to non-performance. If the creditor fulfills his obligations within the deadline, the creditor still has the right to claim damages for the delay. Such damages might, for example, consist of reimbursement of the costs of a rental car if a car dealer was not able to deliver a purchased vehicle on time.

3.4 *Breach of Protective Obligations*

Characteristic of a breach of protective obligations is that it does not involve the timely and faultless performance of the main contractual obligation but rather means that, despite or in addition to the due performance of the main contractual obligation, other items of legal protection held by the creditor were impaired. Such is the case, for example, when the debtor of an obligation to update a software program on the computer system of the creditor negligently damages the monitor screen. The debtor is then liable for damages. In certain exceptional cases, the creditor can even be entitled to avoid the contract if adherence to it would be unreasonable due to substantial violation of protective obligations on the part of the debtor.

3.5 *Delay of the Creditor*

As opposed to the delay of the debtor (*Schuldnerverzug*), the delay of the creditor (*Gläubigerverzug*) occurs whenever the creditor refuses to accept the performance duly offered. The debtor nonetheless remains obliged to perform and normally cannot claim any damages. He can, however, demand reimbursement of any additional expenses incurred in the course of performing his obligations a second time. He can also

deposit his performance at the courthouse. When the creditor is in delay, the risk of accidental loss of the subject matter of the contract is transferred to the creditor, whereby the debtor retains his right to receive the promised counter-performance despite the non-fulfillment of his contractual obligation.

4 Changes in the Contract

4.1 Contract of Amendment (Änderungsvertrag)

A contract can be modified at any time through a further contract if the parties are no longer satisfied with the original content and are in accordance concerning the need for modification. A contract of amendment can address the main contractual obligations, additional accompanying obligations of lesser importance or simple performance details. Accordingly, a subsequent extension of the duration of contract is a contract of amendment.

As a general rule, the contract of amendment must be concluded in the same form as the original contract. The remaining requirements for the validity of the contract likewise remain intact. The special rights of revocation assigned to contracts with consumers are also applicable.

4.2 Assignment (Abtretung)

Contracts can also change through assignment. The creditor has the right to assign his claim against the debtor to a third party; in contracts between merchants it is not even possible to waive that right by way of agreement. In principle, there are no form requirements for an assignment nor is there a need to procure agreement from the debtor or to even provide him with notification of the change. Once the assignment has been made, the debtor is responsible for making payment to the new creditor; thus there has been a change in the contract without any active participation on the part of the debtor.

4.3 Frustration of a Contract

Changes to a contract can be made not only through the concerted action of the contracting parties but can also occur as the result of a legal ordinance. If the circumstances under which the contract was concluded and which have become the basis of the contract, subsequently undergo such radical change that the parties would not have concluded the contract or would not have done so with the same content had they been able to foresee the developments, the party concerned has the right to demand adaptation of the contract.

The basis of a transaction is the totality of assumptions a party has at the time the contract is concluded in regard to the existence or probable future occurrence of certain circumstances and which essentially influenced his decision to enter into the contract. Certain categories of cases have manifested in which the courts have acknowledged the existence of a frustration of contract and the necessity of contractual modification. The most important of the categories are comprised of cases in which the equivalence of contract has been disturbed, cases in which performance has been made significantly more difficult and cases where the purpose of the contract has been frustrated.

A disruption of equivalence of contract exists whenever performance and counter-performance are no longer reasonably balanced in relation to each other. That could specifically be the case if a devaluation of currency were to occur, which would result in the debtor receiving significantly lower pay for his performance than originally planned.

Cases involving increased difficulty of performance are such in which a change of circumstances after conclusion of the contract have increased the effort necessary to ensure its fulfillment to such an enormous extent that the debtor can no longer reasonably be expected to comply with his obligations. That would be the case, for example, if a building contractor were to discover that the ground-water level on the construction site of a house were much higher than expected and that very considerable additional effort and expenses would therefore have to be invested in order to seal off the foundation trench.

Frustrations of the purpose of a contract occur whenever a creditor has lost interest in the fulfillment of the performance obligation because he no longer has any use for it. That can be the case, for example, when a person orders engagement rings and the engagement is later called off.

In all of these cases, insistence upon adaptation of the contract to the altered circumstances is legally justified only if and when the performance of the original contractual obligations would constitute an unreasonable demand on one of the parties. In extreme cases, the party concerned can even avoid the contract if adaptation is not possible.

5 Different Types of Contracts

In categorizing the various types of contract, the Civil Code proceeds by grouping them according to the performance they promise. In the case of non-remunerated contracts, the one and only legal performance obligation is the non-remuneration itself. Remunerated contracts, on the other hand, are categorized according to the performance obligation that does not consist of money. The categories of contracts are thus essentially comprised as follows:

- Contracts for the permanent transferal of the possession of property or rights
- Contracts for the temporary transferal of the possession of property or rights

- Contracts for services or for work and labor
- Contracts for risk assumption

The immediate purpose of these contracts is the exchange of performances.

However, there are also other contract that, as opposed to the ones listed above, do not contain any exchange of performances but rather lay the preparatory groundwork for such exchange. They include preliminary agreements, option agreements and framework agreements.

5.1 Contracts for the Permanent Transferal of Property or Rights

Contracts for the permanent transferal of property or rights are contracts whose purpose is the permanent and final displacement of goods. They include sales, barter, gifts and factoring.

The difference between sales and barter is that in the case of sales the counter-performance for the transferal of the property or right consists of money, whereas in the case of barter it consists of the transferal of another piece of property or another right. Gifts and donations are distinguished from these two types of contracts by virtue of the fact that they do not contain any counter-performance. Factoring is a special form of a sales agreement involving the transferal of a monetary claim for the purpose of converting it into cash more quickly.

Sales and gift/donation agreements themselves do not include the actual transfer of property or a right. A further contract has yet to be concluded whose sole content concerns the act of handing over the property or the assignment of the right.

5.2 Contracts for the Temporary Transferal of Property or Rights

The purpose of contracts for the temporary transferal of property or rights is not the permanent transferal of property or rights but rather a merely temporary transferal that is to be followed by reversed transferal. They include rental contracts, leasing agreements, gratuitous loans, loans intended for consumption and franchising and license agreements.

Rent (*Miete*) and leasing (*Pacht*) differ in that a rental contract only permits use of the property whereas a leasing agreement also allows the leaseholder to draw benefits from its utilization. A business is therefore generally leased, as no profits could be drawn from the operation otherwise.

A gratuitous loan (*Leihe*), like a rental contract, permits the use of property but, unlike the latter, charges no money for it.

A loan intended for consumption (*Darlehen*) is a combination of a rental and sales contract, because it entitles the borrower to keep the property (which consists of money in the majority of cases) but obliges him to return it in generically equivalent form once the loan period has elapsed.

A general leasing contract (*Leasingvertrag*) differs from a rental contract (*Mietvertrag*) in that the lessee assumes total responsibility for the leased item as if he himself were its owner, whereas a renter normally is not liable for the upkeep of the rented property. Thus, a leasing contract is a sales contract for the temporary transfer of property. Typical leasing objects are cars and computer systems.

Franchising and license agreements differ from the foregoing types of contracts in that they are not concerned with the transfer of property but with the temporary transfer of rights, e.g. patent rights. Franchising involves the use of a trademark and, as opposed to a license agreement, regulates the assumption of a completely packaged business model.

5.3 *Contracts for Services or for Work and Labor*

Contracts for services or for work and labor do not involve the transfer of property or rights but rather the performance of activities aimed at the achievement of specific results. They include employment contracts, contracts for professional services, contracted labor and mandates.

Service and employment contracts differ in that the services performed on the basis of a contract for professional services are characterized by the personal, economic and social independence of the provider, whereas under an employment contract an employee, by the very nature of that particular kind of contract, is bound to the instructions of his employer and financially dependent on him. Thus, a typical contract for professional services is a contract with a lawyer or a doctor. German labor law is only partially regulated by statute and depends to a very large extent on judicial decisions (see the chapter “Labor Law”).

As opposed to a contract for professional services (*Dienstvertrag*), a contract for work and labor (*Werkvertrag*) contains a performance obligation consisting of the achievement of a specific result. By way of comparison, a doctor performing on the basis of a contract for professional services is only obliged to provide a specific kind of therapeutic service, not a specific result in the form of a sure cure for the malady. However, a contract for work and labor that concerns having a computer repair does not consist solely of the repair work itself, but also holds the contractor responsible for producing the desired result – the restoration of the computer to working order.

A mandate (*Auftrag*) differs from the foregoing contracts by virtue of its gratuitous nature. A distinction has to be made between a mandate, or contract performed without reward, and simple favors, which are without any legal consequence. Collateral sureties (*Bürgschaften*) are generally based on a corresponding previous mandate of the main debtor issued to the party providing the guarantee.

5.4 Contracts for the Assumption of Risk

The essential purpose of contracts for the assumption of risk is to pass a specific risk on to another party. Typical contracts of this nature are sureties and insurance policies.

In the case of sureties, a third party provides a guarantee to the creditor of the main debtor, promising to fulfill the obligations of the latter in the event of default. The risk assumed by the guarantor is thus the risk of default or frustration of the main debtor's performance ability. As a means of risk containment, i.e. protection of the guarantor, the surety agreement is strictly limited to the principal debt. Once the principal debt has been paid off, the surety is automatically discharged.

An insurance policy is a contract in which the insurer promises to pay a certain amount of money if a specific event should occur. In the case of life insurance policies, that specific event is the occurrence of the death of the insured party within the period of coverage. With liability insurance it is the causation of damage to a third party by the policy holder that gives way to a damage claim against him.

5.5 Preliminary Contracts, Option Agreements, Framework Contracts

Preliminary contracts, option agreements and framework contracts are special types of contracts. What all of these contracts have in common is that they do not contain a concrete exchange of performance, but intend to prepare the groundwork for such an exchange of performance.

5.5.1 Preliminary Contract

A preliminary contract is an obligatory contract which lays the groundwork for a principal contract that is to be concluded at a later point in time; it thus makes preparations for the contract that will determine the exchange of obligations. It makes sense to enter into a preliminary contract whenever factual or legal obstacles still hinder the conclusion of the principal contract, but the parties nonetheless want to make a record of their concurrence to date in order to avoid dispute once the obstacles have been removed. A preliminary requirement, however, is that the parties have reached agreement on all of the essential points and are at least able to determine what the content of the principle contract shall be.

It is necessary to make a clear distinction between a preliminary contract and a letter of intent. The latter merely serves to document the negotiation position of the sender. It is not legally binding nor does it establish any obligations.

5.5.2 Option Agreements

An option agreement is a contract that grants one party the right to make the contract it defines materialize at a later date by way of one-sided declaration. It differs from a preliminary contract in that the principle contract has already been negotiated to the point of closure. At the time the option agreement is concluded, however, one of the parties is not yet ready or willing to issue a binding declaration in regard to the principal contract and instead wishes to have the option of making it come into effect later through one-sided declaration.

5.5.3 Framework Agreement

A framework agreement is concluded for the purpose of outlining the general terms and conditions of a long-term business relationship. It does not specify the content of the separate contracts that are to be concluded on the basis of it, and, accordingly, it cannot be considered a preliminary contract for any specific contract. Instead, it regulates the details of future contracts in such a general way that the conclusion of any specific contract cannot be deducted or assumed. A typical example of a framework agreement is a bank agreement, which regulates the general obligations of mutual consideration of the other party's interests and the advisory obligations involved in the banking procedure.

General Terms of Business (AGB)

A. Stadler and M. Luber

1 Introduction

General terms of business (*Allgemeine Geschäftsbedingungen*, hereafter referred to as AGB), have become so common in German business practice that it is certain they are here to stay. There is no company today that can afford to do without such standardization of its terms of contract if it doesn't want to negotiate every single one of its terms for every transaction it makes. Standardization of a company's conditions of contract in the form of AGB pursues the following objectives:

- Streamlining and standardization of contract closure and processing procedures
- Creation of efficiency advantages, especially through the shortening of the negotiation process but also through the reduction of processing time and effort
- Tailoring of a standard framework for certain types of contracts that are not provided for in the German Civil Code (*Bürgerliches Gesetzbuch*, or BGB) or that are not adequately dealt with there.

The last point contains considerable potential for abuse in that AGB can also be used to shift the bulk of risk to the other party, whereas statutory conditions of contract specifically provide for shared risk. It is especially easy to shift the risk to the other party through the use of standardized general terms of business, because the other party normally does not take the time to read all the complicated details that are contained in the pages of fine print. In most cases customers make their purchasing decision based on price and quality and not on the contents of what appears to them as a set of incomprehensible and boring AGB.

It was because of such abusive unloading of risk onto the unsuspecting customer that German lawmakers stepped in and passed legislation for subjecting AGB to stringent measures of legal control. A law was enacted specifically for the purpose of codifying measures for controlling AGB: The "Act for Regulation of the Legality of General Terms of Business" ("*Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen*", that is "The AGB Act"), which came into effect in Germany on April 1, 1977. During the course of reforming the laws of obligations, lawmakers incorporated the legal measures for controlling AGB into the German Civil Code

(BGB). They are now contained in Section 305 subs. BGB. Due to the enormous role they play in the economy, these regulations may well rank among the most important laws in the country.

Normally, under German law, contracts are regulated only to make sure that they are not null and void due to conflicts with prohibitory laws or because they are unethical in nature; however, whether or not any particular contract is appropriate and fair is not a question of law. The so-called “principle of freedom of contract” is predominant. In contrast, AGB are regulated for fairness and appropriateness. If they violate the statutory requirements, they are to be considered null and void. This can be justified by the fact that, as opposed to “normal” contracts that are negotiated by both parties AGB are contracts whose ready-made terms are imposed upon the other party, providing no leeway for negotiation.

It should be pointed out that the fairness of AGB is not only regulated in the business-to-consumer sector (B2C), but also in the business-to-business (B2B) sector and the consumer-to-consumer (C2C) sector. For the most part, the determination of what exactly is or is not permissible is left up to the discretion of the German courts, which exercise content control. That is to say, the final determination of the validity of any particular set of AGB is an issue of *Richterrecht*, or judicial law. AGB should thus always be drafted by an attorney specialized in AGB law to make sure that their provisions are legally sound and could withstand content control by a judge. Whenever an AGB clause is found to be invalid, non-mandatory statutory law (*dispositives Gesetzesrecht*) applies, which is generally to the disadvantage of the party using the invalid AGB.

This fairness control does not apply, however, either to the content of the goods or services that are to be provided or the amount of money that is to be paid for them. Definitions of the nature, quality and extent of what is to be provided as the main object of the contract do not fall under the content control of AGB law, as such would collide with the Constitution. There can be no law that goes so far as to regulate the very subject matter of any contract by, for example, setting a bottom price. That would undermine the principle of the freedom of contract that by definition is an integral constituting part of a free market economy. However, in order not to hollow out consumer protection law, the regulations of performance and counter-performance contained in any set of AGB are exempted from judicial control, only in so far as they constitute such an integral part of the contract that without them no valid contract would or could exist.

There are four investigative steps involved in the process of determining whether or not any particular set of AGB is permissible:

- Is their subject matter covered by Section 305 subs. BGB? (see Section II below)
- Do they conform to the definition of AGB contained in Section 305 subs. BGB? (see Sections III and IV.A below)
- Have they been integrated into the business transaction (in legal terms: into the actual “contract”) in an effectual, valid manner? (see Sections III and IV.B below)
- Do they pass the content control? (see Sections III and IV.C below)

The last three steps also require differentiation between AGB intended for the business-to-business sector and those designed for business-to-consumer transactions.

If consumers use AGB for private sales transactions with other consumers (C2C-sector), the B2C regulations essentially apply.

2 Coverage of Sections 305 Subs. BGB

As a general rule, all contracts that contain AGB are subject to the controls contained in Section 305 subs. BGB. There are, however, a few important exceptions: According to Section 310 subs. 4 BGB, the statutory regulations do not apply to estate or family contracts, to the articles of the incorporation of a company or to partnership agreements or collective bargaining contracts. It is difficult to imagine that there would be any regular occurrence of disturbances of contractual parity and one-sided presentation of the conditions of contract, in the case of corporate law in particular. Hence, there would not be any legitimate reason to subject internal contracts containing AGB to the controls contained in Section 305 subs. BGB. Contracts of employment, however, are subject to the controls of Section 305 subs. BGB.

3 AGB in the B2B Sector

3.1 AGB as Defined by Sections 305 Subs. BGB

Section 305 BGB determines when conditions of contract are to be considered general terms of business, i.e. AGB that give rise to the controls set forth in Section 305 subs. BGB. AGB are defined as

- Terms of contract
- That are pre-formulated for use in a variety of separate contracts
- And that are dictated by the party using them

3.1.1 Terms of Contract

The only terms of contract or regulations that can be considered AGB are those that constitute the content of an agreement and are legally binding. Mere recommendations, suggestions or requests are not covered by Section 305 subs. BGB.

3.1.2 Pre-Formulation for a Variety of Cases

By definition, terms of contract are pre-formulated if they were firmly defined prior to the contract negotiations, subsequently included in the body of the contract as readymade clauses and were intended to be used repeatedly. The intention of repeated use suffices for qualification as AGB, whereby repeated use is to be understood as meaning at least three times.

3.1.3 Terms Dictated by the Party Using the AGB

The terms of contract can be considered to have been dictated by the party using them whenever that party insists that the pre-formulated terms be included in the contract and makes such inclusion a prerequisite for signing the contract. The other party must not have any real opportunity to alter them, but be forced to accept them as presented if he wishes to complete the transaction. On the other hand, terms of contract are viewed as having been negotiated if and when they have been altered upon the insistence of the other party to the contract, the other party has been granted other advantages for accepting the term or the other party agrees to accept the pre-formulated terms after having considered other possible alternatives, considering them to be fair and just and appropriate to the fulfillment of the contract.

The terms do not actually have to have been dictated by any particular party to the contract for them to be considered AGB. It may suffice if they have been added to the contract by a notary, insofar as the actions of the notary were obviously more focused on one party's interests than on those of the other.

It should be noted that once the contract has been brought to closure, the party using the AGB, that is to say, the party who presented the terms, cannot take recourse in claiming that some provision of the contract was invalid under AGB law, even if that particular clause constitutes a considerable disadvantage for him.

3.2 *Integration into the Legal Transaction (Contract)*

3.2.1 Integration Requirements

There are no special provisions in Section 305 subs. BGB that regulate how AGB becomes a part of legal transactions in the B2B sector. Hence, it is enough for the other party to have somehow become aware of the fact that the AGB of his partner would become an integral part of the legal transaction. For that to happen the party using the AGB must in some way refer to the AGB as binding to the contract and grant the other party the opportunity to examine their content. Of course, the other party must be in agreement with that regulation and must not have refused to have the AGB apply to the transaction. Agreement can be assumed if the transaction is carried out.

AGB can become a part of any legal transaction without notification, only if and when this is industry standard. Until now, such has only been the case with the AGB of banks, airport operators and shipping companies, which have been explicitly recognized in case law.

If both businesses use AGB that contradict each other, neither of the contradictory clauses will become a binding part of the transaction. It makes no difference whether the parties were aware of the collision or whether they explicitly ruled out the validity of the other party's AGB. In such a case the statutory regulations that the parties were actually attempting to rule out now fully apply. A collision of that nature can

be avoided if both parties sign the AGB standard agreement, or if one party signs the AGB of the other, thereby confirming that they shall be exclusively applicable.

3.2.2 Individual Agreement

An individual agreement always has precedence over AGB. Individual agreements encompass not only terms of contract that have been worked out individually, but also those that have been included in the contract of one party by the other. A mere indirect contradiction between a set of AGB and an individual agreement is sufficient for the individual agreement to supersede the AGB. If, for example, a specific delivery date was set during the course of contract negotiations, that agreement would supersede the general regulation contained in the AGB, according to which all delivery dates were to be kept open.

3.3 *Content Control*

3.3.1 Determination of Content

Before the content of any particular general term of business can be controlled, the content itself has to be determined.

Interpretation

AGB are to be interpreted literally and objectively, that is, according to the way they would most likely be understood by honest business partners who are members of the group the AGB address and who are of average intelligence and without any legal schooling. Legal terms, however, are not to be interpreted from a layman's point of view, but rather on the basis of their technical legal meaning.

Ambiguity Rule

In the event that the interpretation of a clause does not lead to a clear and obvious result, Section 305 c BGB applies. Under that particular provision, a content control is initially to proceed from the assumption that the least consumer friendly of all the possible interpretations is the one that was intended. If the clause does succeed in passing the content control even under that worst assumption, the process continues by determining the most consumer friendly of all possible interpretations and that is the meaning that is finally ascribed to the clause. The idea behind this procedure is to force the users of AGB to lay out their terms clearly and unambiguously, if they want to avoid the risk of a clause being declared null and void or of it being left in the contract, but with very advantageous content for the customer in case of doubt.

3.3.2 Surprise Clauses

Surprise clauses are terms of contract that are so unusual that their recipient cannot be expected to have anticipated them. The surprise effect can result from either their content or their position in the body of the contract. An examination of their permissibility needs to investigate what the average consumer could and would reasonably expect them to mean, what their content actually is and whether or not such a discrepancy between the two exists that it can no longer be justified. A surprise clause would thus be, for instance, a clause in a sales contract for a certain product that obliges the buyer to have all of the service work on that product done exclusively by the seller at an extra charge.

Surprise clauses can furthermore be the result of unexpected deviance from the content of presales negotiations.

3.3.3 Fairness Control

General Rule in Section 307 BGB

Section 307 BGB prohibits any and all clauses that unfairly disadvantage the customer. It is the sole basis for content control of AGB in the B2B sector. The catalogues of invalid clauses that are contained in Sections 308 and 309 BGB explicitly do not apply to B2B-activities, but rather only to activities within the B2C sector. Nevertheless, the legal reasoning behind the prohibitions listed in Section 308 BGB can be carried over to the B2B sector by way of the general clause (Section 307 BGB). In doing so, special B2B practices have to be taken into consideration. The prohibitions listed in Section 309, on the other hand, have only a certain indirect influence here. The interests of both parties need to be carefully weighed out, which often results in a clause being declared valid despite the indirect influence of Section 309 BGB. For example, prohibition no. 1 of Section 309 BGB (prohibition of short-term price increases) cannot be applied to the business-to-business sector, since the practice of using current daily (stock-market) prices is a characteristic feature of modern commerce.

An unfair disadvantage exists whenever the clause gives way to a considerable and unjustified imbalance between rights and obligations, thereby violating the principle of good faith to the disadvantage of the recipient of the AGB. It has to be clear that the issuing party intentionally abused his leverage as the sole contract drafter in an attempt to secure his own interests at the expense of his contract partner, without having given sufficient consideration to his interests beforehand and without granting him any adequate compensatory concessions. It should be taken into consideration that an experienced businessman does not need the same amount of legal protection as a consumer, since he more frequently participates in transactions of that order and is thus more aware of the risks.

Indemnity Clauses

Clauses releasing the issuer from liability (or indemnity clauses) constitute a main regulatory component of almost all AGB. A differentiation needs to be made between clauses that provide for total exemption from liability (*Haftungsausschluss*) and ones that (merely) limit the extent of the liability (*Haftungsbeschränkung*) by, for instance, setting a maximum monetary figure or restricting liability to personal or material damage.

Under AGB law, liability for personal damages, intentional damage, damage caused by reckless negligence or simple negligence in violation of contractual obligations that are essential enablers of the fulfillment of the contract cannot be either ruled out or limited. Hence, it is not possible to exclude or limit liability for the inherent contract risks in any kind of AGB. Therefore, for the parties providing the product or service it is all the more important to avoid a situation that would give rise to guarantee or liability claims. That can be done by reducing the extent of performance obligations in the corresponding description of them or by applying restrictive guarantee regulations that are permitted by AGB law, such as shortening warranty time periods and thereby, legally reducing liability risks. Of course, a further possibility that always remains open is individual agreement (for more on that see Section III.B.2 above).

Wherever liability cannot be excluded or limited by way of contract, German civil law comes into play. As a general rule, the BGB provides for unlimited liability for all types of damage and every kind of tort. For that reason, purchasing AGB usually does not include any liability clauses; it is more to the advantage of the recipient of products or service if their provider is held liable under the statutory regulations and thus without restriction.

Transparency Obligation

Unfair disadvantage can result from violation of the transparency obligation or, in other words, from lack of clarity or unmistakable meaning of any given AGB clause. Users of AGB are held responsible for laying out the rights and obligations of their contract partners in the plainest and clearest language possible. The clause must allow its readers to clearly recognize the full and actual extent of its intended financial objectives and any disadvantages it might hold for them. On the other hand, the transparency obligation does not go so far as to force the user to add detailed comments to his AGB elucidating the precise meaning and exact risk of every single term of contract. Principally speaking, the AGB user is not legally responsible for informing his partner in contract about all of the potential risks involved in a more detailed way than any other party of contract.

4 AGB in the B2C Sector

4.1 AGB as Defined by Sections 305 Subs. BGB

In consumer contracts, all clauses have to be considered as AGB, even if they were only intended to be used once, just because of the fact of the consumer contract. Furthermore, they are considered to have been dictated to the consumer if they were not incorporated into the transaction upon his initiative. Hence, virtually any and all terms of contract suggested by the business partner are subject to Section 305 subs. BGB.

4.2 Contractual Integration

AGB become an integral part of a contract only if and when the following minimal prerequisites are met. Their user must have explicitly referred to them before the contract is closed or at the time of closure at the very latest. Later references to them in a delivery note or order confirmation, for instance, do not suffice. Furthermore, the reference must be made explicitly, which is to say it must be possible for the customer to clearly and unmistakably understand it. If making such explicit reference would be extremely difficult, as, for instance, in the case of mass agreements involved in a spectator sport event, it is sufficient to clearly display the general terms of business at the point of sale.

It is essential that the consumer have the opportunity to view the content of the AGB. Thus, they have to be presented to him in accordance with the legal ordinance; any obvious physical handicap on the part of the consumer has to be taken into account.

That rule goes beyond the normal regulation of the BGB. For AGB to become legally binding to consumers it is not enough for them to have simply declared agreement with a set of AGB they have never had a opportunity to review, even though such an opportunity could reasonably have been created. In the event that it is not feasible to make the AGB available to the customer before concluding a sale, as is the case, for example, in sales made on the telephone, the buyer must explicitly waive his right to view the AGB beforehand. That waiver assumes the form of an individual agreement.

4.3 Content Control

Content control in the B2C sector is significantly more stringent than in the B2B sector. That is primarily due to the legal assumption that consumers are less experienced in commercial matters than businesspeople and, therefore, in need of considerably more protection.

Even stricter laws apply to the merchandising of consumer goods. They are contained in Section 474 subs. BGB and for the most part prohibit the supplantation

of the legal statutes with self-designed terms of business in the form of AGB. It is, therefore, necessary to run an additional check on AGB governing the sale of consumer goods to see if they not only conform to Section 305 subs. BGB, but also to the requirements under Section 474 subs. BGB.

4.3.1 Determination of Content

The content of any and all general terms of business are subject to objective interpretation in the B2C sector as well. However, the interpretation process here involves more than just the investigation of the content of the contract. It also includes looking into the surrounding circumstances that prevailed at the time the contract was concluded.

4.3.2 Surprise Clauses

Surprise clauses are inadmissible. There are no special regulations for B2C contracts that deviate from those that are applicable to AGB in the B2B sector as illustrated above.

4.3.3 Fairness Control

The fairness control of AGB in the B2C sector is significantly more extensive than that which is undertaken in the B2B sector. In addition to the general fairness control under Section 307 BGB, the Civil Code contains two catalogues of clauses that explicitly list prohibited contents and result in the nullification of any clauses that incorporate them.

Section 309 BGB strictly prohibits certain types of clauses, ruling them out from the very start and under all circumstances. Section 308 BGB, on the other hand, lists certain types of clauses that are prohibited if and when they unfairly disadvantage the consumer.

Explicit Prohibitions Under Section 309 BGB

The clauses itemized in Section 309 BGB are automatically cancelled and thus require no further investigation. The prohibitory objectives of some of the most relevant single provisions of that paragraph are:

No. 1: Exclusion of price increases for 4 months after contract closure. This is particularly relevant to car dealing, where it is frequently agreed that the customer will pay the list price of the car that is in effect on the day of delivery.

No. 2: Exclusion of any rights to refuse performance of an obligation. The fundamental legal principle of mutual simultaneous performance (*Zug-um-Zug-Leistung*)

in the fulfillment of contracts cannot be arbitrarily put out of effect by any AGB clauses. However, that does not rule out the possibility of agreeing to advance performance, in which case the principle of mutual simultaneous performance would not apply by way of mutual consent.

Nos. 5/6: Restriction of the permissibility of lump-sum damage payments and promises to pay contract penalties.

No. 7: Exclusion of any possibility to rule out liability for personal damage or liability for intentional damage or damage caused by reckless negligence. (For more on this point, see Section III.C.3b above: “Indemnity clauses” in the B2B sector).

No. 8: Exclusion of any possibility to rule out liability for product defects.

Prohibited Clauses with Interpretive Leeway

The prohibitions itemized in Section 308 BGB apply only if and when an evaluation of a contract clause with such content reveals that it contains an unfair disadvantage for the consumer. The purpose of Section 308 in contrast to Section 307 is to create a special assumption for the invalidity of the AGB term. Two of the most relevant regulations of Section 308 are:

No. 3: Prohibits reserving the right to back out of the contract. The user of AGB cannot grant himself the right to back out of the contract without objective reason and without specifically mentioning such reason, since the contrary would in effect mean that the contract was not binding for him.

No. 4: Prohibits reserving the right to make changes in the terms of contract. It is forbidden to make one-sided changes in the performance obligations initially stated unless such appears reasonable under due consideration of the interests of the other party.

Unfair Disadvantage, Section 307 BGB

An unfair disadvantage is to be assumed whenever the clause creates a considerable and unjustified imbalance between rights and obligations, thereby violating the principle of good faith to the disadvantage of the consumer. It has to be clear that the issuing party intentionally abused his leverage as the sole contract drafter in an attempt to secure his own interests at the expense of the consumer, without having given sufficient consideration to his interests beforehand and without granting him any adequate concessions by way of compensation.

In case of doubt, an unfair disadvantage is to be assumed if the term of contract in question considerably deviates from the basic ideas behind the legal regulation, or if the term causes such a restriction of the core rights and obligations of the contract that fulfillment of the purpose of the contract is jeopardized.

When reference is made to the basic ideas behind a given statutory regulation, it is first necessary to differentiate between purely rules of sensibility, which can be altered freely, and normative provisions of justice that contain fundamental principles of fairness and, as such, serve to fulfill consumer protection needs. AGB

cannot contain any deviation from such normative provisions of justice. By way of example, no party can issue AGB that exclude attempts to hold it liable for contributory negligence leading to damage causation.

Core rights and obligations which result from the very nature of the contract are primarily those that are harmoniously weighed out against each other and that are agreed to just because of the existence of the other duty. Also included are secondary obligations that are fundamentally necessary to ensure consumer protection. They must be obligations whose fulfillment is essential in order for the contract to be properly carried out and in which the consumer places his full confidence and, as the law maintains, rightly so. It is thus, for example, impermissible for a vendor to include a clause in his AGB releasing himself from his obligation to provide timely delivery.

Furthermore, an examination as to whether or not any particular set of AGB unfairly disadvantage the consumer cannot be focused solely on the actual content of the contract, but also have to take the surrounding circumstances at the time of contract closure into consideration. Such circumstantial factors would include particularly the consumer's inexperience and/or exploitation of a situation in which the consumer is completely taken by surprise.

5 Legal Consequences

If a clause fails to pass the content control, it is declared null and void in its entirety. There is no legal provision for validity reduction or, in other words, retention of the clause, with a restriction of its validity to the extent that is barely permissible by law. The reason is that, as a general rule, parties to the contract having little or no legal knowledge will not contest the contract in court, but instead accept the terms of contract as they stand, including the invalid clause. The legal system cannot promote exploitation of that situation by making it easy and risk-free for businesses to do so, as would be the case if it were permissible to retain the clause under restriction of its validity to the extent that is barely legally permissible.

However, it is a different matter if the clause can be broken down into various separate parts containing their own distinct terms of contract. In that case, any separable parts that are comprehensible in and of themselves, in terms of both language and content, and which do not raise any legal doubts concerning their permissibility can be retained upon deletion of the inadmissible parts. The decisive factor for determining whether or not a clause is separable in this manner is the so-called "blue-pencil test": If the sentence still makes sense after the impermissible term of contract has been scratched out, it is indeed separable. It is worth noting that if the deletion of the invalid term now puts the other party at an advantage, the issuer of the AGB cannot seek recourse by claiming that the entire clause is null and void.

Nevertheless, clauses that are not permissible under Section 305 subs. and result in nullification are not generally forbidden. The parties to a contract always have the unrestricted option of freely negotiating the terms. If they have been agreed to individually and mutually, as a general rule they are legal and valid (see Section III.B above).

The contract containing invalid AGB or ones that were not effectively integrated into remains legally binding as a whole although after nullification of its inadmissible provisions. The only exception to that general rule is if adherence to the revised contract would subject one of the parties to unreasonable hardship due to the fact that the deletion completely changed the contract and, especially, fundamentally disrupted the balance of rights and obligations. The gap caused in such an exceptional case is to be closed by application of the relevant statutory provisions and, subordinately, through supplementary interpretation of the contract. Hence, the statutory provision that ultimately comes into effect is precisely the one that the AGB was attempting to supplant.

Furthermore, the use of impermissible general terms of business can rise to a liability for damages on the basis of culpa in contrahendo. The initiation of contractual negotiations can give way to a relationship of mutual trust that obliges both parties to be considerate of the other's interests. The negligent causation of a void contract because of the use of invalid AGB therefore gives rise to liability for damage compensation.

6 Control Through Consumer Protection Agencies Exercised by Way of Suits Filed for Discontinuance

As mentioned above, the user of invalid AGB runs a high risk of losing a court battle to his contract partner, as the law restrains him from gaining any advantage over his partner in contract by himself seeking recourse in the terms of contract that have been declared null and void. He furthermore runs the risk of being warned by a consumer protection agency, independent of any concrete legal transaction involving a specific contract partner, to refrain from using the invalid AGB and of being sued for discontinuance by the agency if he does not heed their warning. The laws enabling the filing of suits for discontinuance (*Unterlassungsklagengesetz*) serve the purpose of preventing abuse of AGB and allow for the transference of cost risk from the individual consumer to a nonprofit agency or association. Judgments against the users of invalid AGB attained upon the initiative of consumer protection agencies have a much wider scope of effect; any parties that have a contractual relationship with the user can support their own claims on the basis of such judgments.

7 Suits for Discontinuance Filed Under Unfair Competition Laws

A final risk that is taken by the user of invalid AGB is that of being warned by competitors to discontinue unfair competitive practices and of being taken to court under the laws regulating competition, in order to force them to refrain from using the impermissible AGB.

Under the Unfair Competition Act (*Gesetz gegen den unlauteren Wettbewerb*, or UWG), it can be assumed that unfair competition is taking place whenever one market player is obviously exploiting consumer inexperience in business affairs, and particularly their lack of legal knowledge, in order to gain a competitive advantage. This would include the use of invalid AGB. Thus, any party issuing impermissible standard terms of contract can be sued for discontinuance of such practices by his competitors. The practices might include hidden and therefore unlawful limitations of liability, which would give consumers the false impression that they were dealing with a better, more competitive offer.

In conclusion, it can be said that the use of AGB present business enterprises with very considerable advantages, yet they can also prove to involve a great deal of risk if they have not been carefully formulated.

Torts

T. Tremml

1 Introduction

The German legal system recognizes two different grounds for compensatory liability. The one is liability resulting from a contract (contractual liability), the other is liability that is provided for by law (statutory liability).

Liability resulting from torts, or unlawful conduct, is the most important form of statutory liability. German law defines a tort (*Delikt*) as the liability of one person to provide damage compensation to another person whom he has unlawfully harmed. German law (as opposed to the French *Code Civil*, for example) does not have a general clause standardizing the requirements for the existence of a tort, but rather presents a catalogue of various torts in the German Civil Code [*Bürgerliches Gesetzbuch* (BGB)] as well as in several other, more specific, laws. Unlike Anglo-Saxon law, German law does not provide for case-law or judicial determination of any torts. German law limits itself to codified torts.

It is important to note that, as a general principle, tort liability is independent of any claims to liability arising from contractual relationships. It is only by way of exception that contract stipulations determine the liability arising from torts. Such could be the case, for example, if the parties agreed to a certain time limitation for claiming damages, to a specific measure for determining fault or a maximum amount of liability. (It is advisable, therefore, to explicitly extend contractual limitations to tort liability, while recognizing the statutory minimum standards, of course). A common example of such contractual restrictions can be found in employment contracts, which limit the employees' liability towards their employers for damages caused in the performance of their regular duties. In order to prevent the Employer from seeking recourse in tort law to recover the remaining share of the damage caused through the employee's unlawful conduct, thus rendering the contractual limitation of liability practically ineffectual, the courts have ruled that in such cases the contractual limitation is to be extended to any claims under tort law.

A wrongful deed that causes damage can give rise to several contractual or statutory claims at the same time. However, compensation can only be claimed once and is restricted to the actual figure of the damage inflicted.

2 General Requirements for Tort Liability

Liability for injuries inflicted through unlawful conduct can stem not only from actions but also from omissions. The person causing harm through omission can be held liable for the damages incurred, however, only if and when he had the legal obligation to act. Legal obligations of this kind often do arise in particular from safety, security and supervisory duties. For instance, the operator of a supermarket can be held liable for any harm suffered by his customers if he has failed to take adequate measures to ensure their safety on his premises.

A further requirement for establishing tort liability is that the person charged with unlawful conduct must have infringed a protected right or object, as each of the torts is aimed at offering legal protection to a specific right or object. If no specific one of them has been infringed, no grounds exist for asserting tort liability. (A list of the torts recognized by German law as well as the corresponding objects of legal protection is included later below, in Sect. 5.). Thus, it can be seen that compensation cannot be claimed for every kind of injury resulting from unlawful conduct. (Of course, other legal grounds outside of tort law may exist for holding the perpetrator liable, such as contractual liability).

The German tort law system differentiates between (1) statutory cases of liability that come into being through unlawful conduct, whether it be intentional or negligent, and (2) cases of strict liability resulting from jeopardizing public safety, which occurs independent of anyone's fault (*Gefährdungshaftung*, no-fault torts). Hence, only the first type requires the unlawfulness of the act and the perpetrator's fault.

According to the general regulations of the German civil procedure, every party involved in litigation has the responsibility of producing evidence to support their arguments. The burden of proof in any particular case of tort liability therefore rests with the party suing for damages. The same applies to proving the intent or negligence of the perpetrator. However, an exception may be found in the case of "presumed negligence", in which the perpetrator is assumed to have acted negligently as long as he can present no evidence to exonerate himself. This, in effect, amounts to a reversal of the burden of proof, but only as concerns fault. By way of exception, the party being held liable must prove that he has not acted negligently or with intent.

Such a reversal of the burden of proof also exists in certain special liability cases, such as cases involving "manufacturer's liability": If a person or an object is damaged in the course of using an industrial product according to the manufacturer's instructions, due to some flaw in the product's construction, the manufacturer is in this case responsible for providing evidence that there was no negligence on his part that led to the flaw. A distinction must be drawn between this concept of "manufacturer's liability" (*Produzentenhaftung*) and the concept of "product liability" (*Produkthaftung*). While "manufacturer's liability" is strictly based on unlawful conduct and fault (albeit with a reversed burden of proof), "product liability" refers to certain no-fault torts, which are by definition completely independent of any unlawful conduct, negligence, or intent (more on this under point V.C. below and in the product liability chapter of this book).

3 Legal Consequence: Damage Compensation

A tortfeasor is liable for damages to the object of legal protection caused by his act or omission. The amount can be reduced, however, if the wronged party is found guilty of contributory negligence.

The type and amount of compensation are determined by the general principle governing the German laws of compensation, which is restitution in kind. (Some isolated cases standardize certain modifications, but these can be discounted here). According to the principle of restitution in kind, the liable party is responsible for the restitution of the condition that the claimant would have found himself in if the damage had not occurred. In other words, the compensation is meant to be a means of balancing out the losses that were sustained and it is thus restricted to the actual amount of the damage sustained. Unlike in the U.S., compensation under German civil law does not have any punitive function. (Monetary penalties payable to the state can be imposed for misdemeanours and felonies, of course).

While the liable party must generally compensate the total amount of the damage, there are some specific cases, however, in which the maximum amount of liability is set by law. In the realm of labor law, case law may restrict the amount of employer claims against employees as well (see Sect. 1 above).

In place of restitution of the original condition by the perpetrator or his agent, a person who has sustained pecuniary (property or bodily) damage can claim the corresponding monetary amount needed for restitution in kind. The same restitutionary principle applies to non-pecuniary damages. For example, a newspaper that tainted someone's reputation by printing false and defamatory information has the legal obligation to rectify the situation by publishing a corrective statement. However, if the restitution of non-pecuniary damages is not possible in kind, because the damage cannot be made good by running a corrective statement, for instance, the claim is generally discarded as insubstantial. It is only in particular cases that financial compensation is awarded for non-pecuniary damages. One such exception is compensation for pain and suffering incurred through bodily injury or invasion of privacy (this also includes public insults, abuse of a person's right to his or her own name and likeness, etc.).

The sums that German courts award to claimants as compensation for pain and suffering are only a fraction of what tends to be awarded by U.S. courts. Even in extreme cases, the compensation is generally somewhere in the range of € 250,000–350,000. To cite just one example: in a case that was recently tried before the Higher Court of Hamm, a child that suffered irreparable and severe brain damage at birth due to malpractice was awarded approximately € 250,000 as compensation.

In cases that ultimately lead to the death of an individual, the victim himself has the right to claim compensation for pain and suffering (which can be legally pursued by his heirs), but only if his death is not instantaneous. Only in highly exceptional cases do the survivors have their own rights to claim compensation for pain and suffering, and even then only in very minimal amounts. In 1995, the Higher

Court of Nuremberg awarded a father who had lost three children compensation for pain and suffering that amounted to about € 35,000.

Again, it must be noted that claims for compensation for material damages are generally not restricted and may cover the cost of medical treatment or the loss of earnings, for example. Also, in case of the killing of a person who is legally obliged to provide maintenance to a third person (e.g. the killing of a parent responsible for child support), the loss of support payments may be claimed by that third person (e.g. the child) as material damage in accordance with Section 844 II of the German Civil Code (BGB).

In addition to the right to claim compensation, Section 1004 of the German Civil Code (BGB) grants a person whose rights under Sections 823 I, 823 II, 824 and 826 have been unlawfully impaired, an additional right to have the nuisance removed or stopped (see below and Sect. 5 for details).

4 Exemption from Liability in the Case of Compulsory Workers' Insurance Against Accidents at Work and Employment-Related Illnesses

Under German law, all employees are automatically state-insured against work accidents and job-related illnesses. The compulsory insurance payments are covered by the employers without any employee contribution. In return, under Section 104 of the Federal Public Welfare Law, Vol. VII [*Sozialgesetzbuch (SGB VII)*] employers are released from all liability for bodily injury sustained by their employees (but not for any property damages) in the course of performing their jobs as well as for liability resulting from job-related illnesses. Liability for such damage is transferred instead to the state insurance organization. However, this liability exemption principle is not applicable in cases in which accidents are deliberately caused by the employer or in accidents that occur en route to the workplace.

5 Specific Torts as Defined by German Law

The torts that are recognized in Germany are defined in a wide variety of different laws. As already mentioned, there is no liability for unlawful conduct if there has been no damage done to persons or property under legal protection as specifically defined in the various statutes.

Below is a summary of the specific torts most pertinent to the everyday practice of German business law. The manner of presentation can only be a general overview since each of the torts inherently contains a detailed complex problem. The regulations pertaining to product liability, which are of particular importance here, will be discussed at length in the respective chapter of this book.

5.1 Torts Requiring Proof of Negligence by the Claimant

5.1.1 Section 823 I German Civil Code (BGB)

Sections 823 I and II BGB are the most common torts. Section 823 I is aimed at protecting the so-called absolute rights, which include the following:

- (a) Life, body and health;
- (b) Property, certain property rights (e.g. mortgages and liens) and certain forms of possession;
- (c) Rights to intellectual property (e.g. patents, copyrights, design patents and trademarks);
- (d) General personal rights (e.g. privacy rights, rights to protection against defamation of character, rights to one's own name or company logo, rights to one's own picture);
- (e) Rights to an up-and-running business operation (this right safeguards everything that, in its entirety, comprises the total economic value of the specific business operation).

5.1.2 Section 823 German Civil Code (BGB)

Section 823 II BGB contains an entitlement to damages resulting from the violation of so-called protective legislative provisions. A protective legislative provision is not just any law, but rather one that strives to offer special protection to a particular group of individuals. This could be any regulation, independent of whether it was passed by a community, a state, the federal government or the European Union and regardless of the field of law to which it belongs. The protective legislative provisions whose violation can entail liability for damages under Section 823 II BGB include, among other things, the following:

- (a) Certain misdemeanour and felony statutes;
- (b) Certain product safety and consumer protection regulations (whereby this area often additionally contains no-fault liability for jeopardizing public safety, see sec. C. below);
- (c) Certain regulations that offer protection against impairments or nuisances emanating from adjacent property (this frequently also entails no-fault liability);
- (d) Certain environmental protection laws;
- (e) Certain labor law provisions, e.g.
 - Section 9 II of the Maternity Protection Act [Mutterschutzgesetz (MuSchG)] forbids the termination of the employment contract of a woman during her pregnancy or within the first 4 months following the birth of her child.
- (f) Certain provisions of bankruptcy and corporate law, e.g.

- Section 92 II and III and Section 401 of the Stock Corporation Act [*Aktiengesetz* (AktG)] mandates that the board of directors of a stock corporation must file for the opening of bankruptcy proceedings and is not permitted to make any further payments when confronted with insolvency.
 - Section 64 I of the GmbH Act (law governing limited liability companies) [*GmbH-Gesetz* (GmbHG)] mandates that the managing director of a limited liability company must file for bankruptcy when confronted with insolvency.
 - Section 399 No. 4 of the Stock Corporation Act (AktG) stipulates that the members of the board of directors and the supervisory board are not allowed to make any false claims or fail to disclose relevant information when in the process of a capital increase.
 - Section 400 of the Stock Corporation Act (AktG) restrains the members of the supervisory board and the board of directors from making any incorrect statements or disguising facts when providing the assembly of stockholders and the public auditor with the information they are entitled to by law.
 - Section 264 II of the Commercial Code [*Handelsgesetzbuch* (HGB)] requires corporations to prepare financial statements for every fiscal year that conform with the principles of proper accounting.
- (g) Certain provisions of the laws on competition and copyright law, e.g.:
- Section 16 of the Unfair Competition Act [*Gesetz gegen den unlauteren Wettbewerb* (UWG)] prohibits misleading advertising.
 - Sections 127, 144 of the Trademark Act [*Markengesetz* (MarkenG)] prohibits the misleading use of indications of the geographical origins of goods and services.
 - Section 17 of the Unfair Competition Act (UWG) prohibits disclosure of company or business secrets.
 - Article 81 of the Agreement for the Establishment of the European Community [*Vertrag zur Gründung der Europäischen Gemeinschaft* (EGV)] prohibits agreements between companies that would have the potential to impact negatively free trade among the member states of the EU.
 - Section 95a of the Copyright Act [*Urhebergesetz* (UrhG)] prohibits the circumvention of technical precautions that serve to protect copyrighted works
- (h) Certain provisions that require previous licensing or official notification of certain business activities, e.g.
- Section 144a of the Insurance Supervision Law
 - [*Versicherungsaufsichtsgesetz* (VAG)] prohibits the brokering of insurance policies and retirement funds without a license.
 - Sections 32 and 54 of the Lending Business Act [*Kreditwesengesetz* (KWG)] forbids commercial involvement in banking operations or other financial services without a license.
 - Sections 132 and 139 Law on Investments [*Investmentgesetz* (InvG)] prohibit the sale of foreign investment shares publicly without having filed official notification.

5.1.3 Section 824 BGB

This regulation provides compensation for damages from false allegations of fact capable of adversely affecting a person's credit rating.

5.1.4 Section 826 BGB

Under Section 826 BGB anyone who intentionally causes damage to another person in an unethical way is liable for compensation.

5.1.5 Section 839 BGB

Section 839 BGB grants compensation to any citizen who has suffered damage as a result of a civil servant's violation of official duties.

5.2 Torts That Presume Fault

There are a number of torts that require fault on the part of the perpetrator but which proceed from the rebuttable presumption that such fault exists. In such cases, it is up to the *defendant* to invalidate the presumption by providing evidence to the contrary.

5.2.1 Section 831 BGB

This provision holds "masters" (employers) liable for the actions of their "servants" (employees of the business or any other vicarious agents). Whether or not the vicarious agents themselves were at fault is irrelevant here. Responsibility is carried by the master, who is presumed to have committed a fault in the selection or supervision of his vicarious agents or by not having provided them with the proper equipment and tools for performing their jobs correctly. The master can rebut this presumption of fault only by proving the contrary.

5.2.2 Sections 836–838 BGB

These provisions hold the current or former owner of a piece of real estate or a building or the person in charge of its upkeep liable for damages caused by a collapse of the building or by parts of it falling off or caving in due to construction defects or negligent upkeep. In this case, too, the law proceeds from a presumption of fault on the part of the person responsible. These sections of the BGB provide legal protection only to life, body, health and property.

5.3 No-fault Torts (“Gefährdungshaftung”)

5.3.1 Sections 1–2 Liability Act [Haftpflichtgesetz (HaftpflG)]

Under Section 1 HaftpflG, the person running a railroad or sky-rail business is liable for personal or property damages occurring as a result of its operation, whether or not he is at fault. This does not cover damages to goods that are being transported unless they are in the immediate possession of a passenger, nor does it cover items taken into custody by the operator of the business. Liability is completely ruled out whenever the accident is caused by *force majeure*.

Section 2 HaftpflG standardizes two different types of no-fault liability for the owner of a power plant or pipeline plant or plant providing electricity, gas, steam or liquids. Regardless of fault, the owner is liable for all personal and property damage caused by the effects of electricity, gases, vapours or liquids (impact liability). Furthermore, he is liable in the same way for any and all personal and property damages that are not caused by the energy or substances being transported within the plant, but instead are due to mechanical failure (maintenance liability), unless the plant’s condition corresponded with the technical state of the art and was fully capable of functioning properly. Impact and maintenance liability are excluded if the damage was caused by *force majeure*. However, this restriction does not apply to damage caused by power lines falling down. Liability is further excluded when damage occurs in a building belonging to the plant or adjacent property, when a machine or device belonging to the end user (such as a refrigerator or a water faucet) has been defective or has caused the damage itself.

Liability under Sections 1–2 HaftpflG is restricted to € 600,000 per injured or deceased person. In the case of property damage other than damage to real estate, it is limited to € 300,000 per accident.

5.3.2 Sections 1–2 Environmental Liability Act [Umwelthaftungsgesetz (UmweltHG)]

The Environmental Liability Act (UmweltHG) is applicable to certain plants engaged in such diverse activities as heat production, mining, energy production, procurement and processing of construction materials, metal processing, production and processing of chemical products, refinement of mineral oil, surface treatment of objects, processing of resins and plastics, procurement and processing of cellular matter, lumber processing, agriculture, waste treatment and recycling or the storage of dangerous substances (as well as many other types of installations). Under Sections 1 and 2 of the Environmental Liability Act, the owners of such facilities are liable for all personal and property damages caused by an environmental impact originating in their plant. This is another instance of liability for placing at risk public safety (*Gefährdungshaftung*) which exists independent of any fault or violation of law.

However, the Environmental Liability Act goes a step further and, as provided by Sections 6 and 7 UmweltHG, assumes that the damage sustained was a direct

cause of the environmental impact if the installation was capable of causing that specific type of damage. Such capability is determined primarily by the plant operations, the equipment used, the type and concentration of the substance used and released, the prevailing meteorological conditions, the time and place the incident occurred and the overall nature of the damage. Thus, basing an argument on such criteria, the person impaired has to prove that the plant is *capable* of causing the particular type of damage he claims to have incurred in order to substantiate the statutory assumption of causation (“*Kausalitätsvermutung*”). Consequently, it is up to the owner of the plant to prove that the damage was *not* caused by an environmental impact that originated in his works. This assumption of causation does not apply if the damage can be seen as having originated in other circumstances particular to the case at hand (not, however, in circumstances related to another plant regulated by the Environmental Liability Act). The assumption of causation also does not apply if the plant was adequately and properly operated, which is in turn assumed if the controlling procedures demanded by law had been duly carried out in the relevant timeframe without incident.

If the plant was operating in such correct fashion, the owner is released from liability for any property damage caused by insignificant environmental degradation or by such damage that is normal for the particular area. Compensation claims for personal and property damage cannot exceed the maximum amount of € 85 million each per incident. No liability for damages exists in the event of *force majeure*.

5.3.3 Section 22 I and II Water Conservation Act [*Wasserhaushaltsgesetz* (WHG)]

Under Section 22 I WHG, anyone who causes damage by polluting surface or ground water or who alters the physical, chemical or biological composition of the water supply is held responsible regardless of fault.

Section 22 II WHG states that the owner of a manufacturing, processing, storage or transportation plant is liable for damages caused by the leakage of any of the substances that are produced, stored or transported there into the surface or ground water. There is no liability for damages caused by *force majeure*.

5.3.4 Section 32 Gene Technology Act [*Gentechnikgesetz* (GenTG)]

Section 32 GenTG provides that anyone may be held liable for jeopardizing public safety regardless of fault who, without permission, releases organisms that have been genetically manipulated, brings products containing such genetically manipulated organisms into circulation or is involved in genetic manipulation. Section 32 GenTG does not apply to the use of genetically manipulated organisms on human beings, specifically, not to the use of drugs and medicine.

Section 32 GenTG protects only against damages specifically engendered by the genetically manipulated properties of the organism (as opposed to original,

non-manipulated properties of the organism). It is assumed that such is the case as long as it is clear that the damage was caused by the organisms. In order to rebut this assumption, all the defendant has to do is to demonstrate convincingly that on the balance of probabilities the injury sustained cannot be traced back to any of the genetically manipulated properties of the substance.

Liability based on Section 32 GenTG (but not on other torts) is limited to € 85 million per damaging incident. Depending on the type of activity, the taking out of a minimum level of liability insurance may be compulsory.

5.3.5 Section 1 Product Liability Act [*Produkthaftungsgesetz (ProdHaftG)*]

This provision regulates manufacturers' liability for product defects. The same liability is carried by importers of products that are intended to be resold, subtlet or otherwise marketed within the European Union. In the event that the manufacturer or importer cannot be identified, liability is carried by the supplier. Section 1 ProdHaftG grants compensation for damage inflicted upon life, body, health and property. However, property is eligible for compensation for damages sustained only if and when it and the defective product are not one and the same, and if and when it was intended and used for private consumption.

Property damages include an own-risk share amounting to € 500. There is no maximum limit of liability for property damage. The amount of personal damage that can be claimed is restricted to a maximum of € 85 million per product or for several identical products with the same defect. An in-depth portrayal of product liability can be found in the respective chapter of this book.

5.3.6 Section 84 Pharmaceutical Products Act [*Arzneimittelgesetz (ArzneimittelG)*]

Section 84 ArzneimittelG provides for the no-fault liability for introducing *pharmaceuticals* into the market that require government approval or that have been released from such approval requirements by executive order. The maker can be held liable for compensation of all personal damages sustained if the product had significant detrimental effects. The maker is furthermore responsible for all personal damages sustained as a result of false labelling or false trade or consumer information.

If the pharmaceutical product is capable of causing the type of damage sustained in any particular case, it is assumed in accordance with Section 84 II ArzneimittelG that it did indeed cause the damage. The damaged person needs only to prove that the pharmaceutical product is theoretically capable of having caused the damage, particularly in light of its composition, the dosage, the type of treatment and its duration, the coinciding of its administration and the origination of the damage, the nature of the damage and the health condition of the damaged person. Of course, the pharmaceutical manufacturer has the possibility of rebutting the presumption of

causation by proving that the product cannot be causally linked to the damage claimed. (However, the manufacturer may not argue generally that the damage was caused by the use of other pharmaceuticals subject to the liability of the Pharmaceutical Act).

The maximum amount of compensation that can be claimed is limited to € 600,000 per person and € 120 million per product. The manufacturer must provide preventive coverage for this amount, for example, through liability insurance or a guarantee by a domestic bank.

Product Liability Under German and European Law

R. Grote

Product liability is generally taken to mean liability for personal injury and damage to property attributable to a defective product and applies to anyone manufacturing or dealing in defective products or components. It applies equally to manufacturers and dealers. Such persons are liable not only to the consumer but also to each other, irrespective of whether products for private or commercial use are involved.

1 Introduction

German product liability legislation is set out in the *Gesetz über die Haftung für fehlerhafte Produkte* (Product liability law) of 15 December 1989 and is based on the European Product Liability Directive 85/374/EEC of 25 July 1985. This directive is intended to improve consumer protection and to harmonize product liability within the member states of the European Union. The member states have issued national regulations based on the Product Liability Directive. However, the German Product liability law and the Product Liability Directive upon which it is based do not cover all relevant aspects of product liability. All areas not included within the scope of the Product liability law remain subject to the provisions of the law of tort. Prior to the enactment of the Product liability law, liability for defective products had been covered by the general law of tort, having been developed and expanded by jurisprudence on the basis of extremely extensive case law. Both the requirements and the legal consequences as set forth in the Product liability law differ from those provided for in tort law. In cases where the Product liability law provides no or only partial satisfaction for a claim for damages, it must always be considered whether liability may be established in casu under the law of tort. The different requirements for and legal consequences of liability are set out below, albeit only in summary.

Liability for defective products may be established not only under the law of tort, but also under the law of contract. Contract claims can only be pursued between the contractual parties. Where no contract exists, only claims under the law of tort or product liability law can be considered. Claims under contract differ from claims in tort or under product liability law in terms of liability. This does not

preclude concurrent claims from being brought, provided the relevant requirements are met. The distinction between contractual and other types of claims is significant, not only in terms of their requirements and legal consequences, but particularly where the contractual counterpart is insolvent. Although claims under contract cannot be enforced in such circumstances, it may be possible to pursue claims under the law of tort or product liability law against persons in the commercial distribution and/or manufacturing chain. Contractual claims based on defective products are derived from the law of obligations as pursuant to the German Civil Code. As the law of obligations was revised effective 1 January 2002, the former version of the law of obligations applies to all contracts concluded prior to that date, with the exception of continuous obligations. The new law of obligations applies to continuous obligations beginning 1 January 2003. This application has been restricted to claims involving defective products under the new law of obligations, as all such claims under the old version of that law will have become subject to the statute of limitations of 31 December 2004.

Finally, Sect. 4 deals with the Equipment and Products Safety Act, which serves to introduce the second EC Product Safety Directive 2001/1995/EC into German law. The Equipment and Product Safety Act concerns governmental monitoring of the market for technical working materials and equipment and consumer products.

2 Product Liability Law

1. Product liability law regulates the liability of manufacturers for defective products.

A *manufacturer* is deemed to be anyone producing a final product, a primary material or a part-product. Importers and dealers who have sold such final products, primary materials or part-products may also be liable under this law. Even someone who merely assembles part-products according to a specific assembly drawing is also deemed to be the actual manufacturer of the end product. If primary materials and/or part-products are already defective, the final product is also deemed to be defective, with the result that several manufacturers may be jointly liable.

Importers introducing the product into the territory covered by the Convention on the European Importers Economic Area are treated as manufacturers, so that the damaged party may also pursue his claims in Germany.

Also treated as a manufacturer is anyone purporting to be a manufacturer by applying his name, trademark or other distinguishing mark to the product. This includes vendor chains which often arrange manufacturing in low-wage countries and which market the product as their own. An entity is treated as a manufacturer when it utilizes a name, trademark or other distinguishing mark that is so closely linked to the product as to constitute misrepresentation vis-à-vis the actual manufacturer.

This does not apply if the products are merely sold under a brand name, since the owner of the brand is not suggesting that he is the actual manufacturer. However,

this does not apply to licensors, since the licensee and not the licensor applies the name, trademark or other licensed distinguishing mark to the product itself. It is advisable to require the licensee to identify himself as the manufacturer.

Apart from importers, product liability law on principle does not apply to *dealers*. However, if the manufacturer of a product cannot be identified, the dealer who has supplied the product is deemed to be the manufacturer, unless he can name the manufacturer or the person who supplied the product. Dealers must therefore maintain full documentation regarding the provenance of their goods, as dealers often hold no or only insufficient product liability insurance. Even if the manufacturer is known, a dealer will still be liable if he is unable to name the importer of a product imported into the territory covered by the Convention on the European Economic Area. This is again intended to allow damaged parties the right to pursue their claims outside Germany.

2. Products are deemed to be movables when manufactured by industrial or handicraft process, including electricity and other energy supplies in the form of water or gas. Even human body parts may be regarded as products if there is an intent to market them. However, in this regard, a product defect can only arise if the products are subjected to improper handling. Although natural produce cannot be manufactured, they are covered by product liability law and anyone producing a natural product is treated as a manufacturer.

Product liability law does not cover pharmaceuticals intended for human use which are subject to license or exempt from licensing by statutory regulation. The Pharmaceuticals Act of 24 August 1976 takes precedence in this regard. Other areas where the product liability law is subordinate are nuclear damage which is regulated by the Atomic Energy Law, and products containing or composed of genetically modified materials, which are covered by the Genetic Technology Law of 20 June 1990. Apart from these exceptions, product liability law applies without restriction to all products manufactured by industrial or handicraft process, including natural produce.

3. Liability applies to products if they were defective at the time they were brought onto the market. Product liability law provides that a product is deemed to be defective if it fails to provide the safety which one would justifiably expect of it. This in turn depends on how the product is presented to the general public, its intended purpose and when it was brought into the market. It is generally expected that a product will not cause personal injury or damage to property if it is used in the intended manner. The intended manner of use of a product will generally be determined by the instructions for use. Other forms of presentation such as the product description or packaging may also include instructions for use. Nevertheless, the potential for both customary and intended use and unintentional and reasonable misuse must be considered when determining the type of use that is reasonably foreseeable.

When considering justified expectations of safety, the decisive criterion is the time when the product was brought onto the market. For example, it is not possible

to apply the same safety requirements to a motor vehicle produced 30 years ago as those of a new model. A specific provision for this in the product liability law states that a product is not deemed to be defective simply because an improved product has been subsequently brought onto the market. Whether or not the older product is defective is determined according to the reasonable expectations of safety prevailing at the time when it was brought onto the market. Such reasonable expectations depend on all the relevant circumstances. A product may at the very least be expected to comply with the acknowledged state of the art, irrespective of whether the product is expensive or low-cost. Nevertheless, reasonable expectations of safety may differ if there are different price classes for the same product. For instance, different safety expectations apply to luxury vehicles than to economy cars.

4. Defects in products may be attributable to their design, manufacture or their instructions for use. Extensive case law has been developed for these categories of defects. A characteristic feature of design defects is that they affect the entire product series manufactured according to the defective design. By contrast, manufacturing defects only affect individual products. Manufacturing defects also include one-off “rogue items”, which are unavoidable despite all reasonable precautions. The term instructional defects refers to cases in which the manufacturer has supplied deficient instructions for use with the product, and when no warning is given of risks which may arise from incorrect, but not unreasonably imprudent use of the product. In all cases, the yardstick for the manufacturer’s duty to warn consumers is measured to standards considering the user group at highest risk. However, if the manufacturer is entitled to assume that the product will be used exclusively by persons familiar with the risks, the duty to warn users may not apply.
5. The product defects described above must be *causal* for the injury or damage arising, and the question as to whether this is indeed the case must in all cases be carefully examined, as shown by the following example.

A manufacturer of alarm systems ordered bolts from his supplier. The supplier produced the bolts based on a design drawing provided by the manufacturer. The alarm systems to which the bolts were fitted failed to work and it was established that the bolts were not of the length stipulated in the manufacturer’s design drawing. Nevertheless, this error was deemed not to be causal for the damage occurring. If the bolts had indeed been of the length specified in the design drawing, the alarm systems would still not have worked. The cause of the damage was thus not a manufacturing defect attributable to the supplier, and a design defect on the part of the manufacturer and the supplier did not render liable either the manufacturer or the users of the alarm systems.

Instructional defects are only deemed to be causal for damage if the damage arising would unquestionably have been avoided if the instruction had been given.

6. Under the Product liability law, only those damages are compensated which arise where someone is killed or in the event of damage to health or property. Purely pecuniary damages are not allowed which have not occurred as a result of the acts of infringement as detailed above. Pecuniary damage is only subject

to compensation if it occurs as a consequence of personal injury or damage to property. For example, no claim for damages may be brought against a manufacturer if a holiday journey cannot be undertaken due to a product defect in the holidaymaker's vehicle.

Where damage to property is concerned, compensation is only available if the damaged item was in private use. For instance, damages incurred as a result of a defective household appliance in private premises can be compensated for, but not damages resulting from the same appliance used for commercial purposes.

A further restriction is also, that only items other than the defective product are subject to compensation. This may result in problems of differentiation if an otherwise flawless end product is damaged by a defective and functionally distinct part-product. It is thus disputed whether the manufacturer of an end product may be entitled to claims for damages if the end product is damaged or destroyed due to a defective part-product provided by his supplier. However, this disputed case group is covered not by the Product liability law, but by the law of tort, as the Product liability law requires that the damaged item be by its very nature customarily intended for private use or consumption, whereas an end product is generally used by its manufacturer for commercial purposes. By contrast, if defective replacement parts cause damage to an item in private use, this falls within the scope of the Product liability law.

7. Under the Product liability law, the *burden of proof* for the defect, the damage and the causal connection between defect and damage lies with the claimant. However, even before the Product liability law came into force case law precedents had already developed certain moderations in this regard, up to and including reversal of the burden of proof, within the scope of the general provisions of tort law. Thus, if a manufacturer has failed to comply with the recognised state of the art, *prima facie* evidence would suggest that the damage occurred as a result of that failure.
8. The Product liability law does not require that the defect was culpably caused by the manufacturer and indeed establishes *no-fault liability* for product defects. However, the Product liability law does provide for exclusions from liability, with the manufacturer being required to prove that the requirements for such exclusions have been met.

Even if the product was defective and the defect was causal for the damage, the manufacturer is not liable for damages if he is able to prove that he was not responsible for introducing the product to the market or that at the time when he brought the product onto the market the defect did not exist or was in compliance with mandatory regulations or could not be detected under the state of the art at the time. Moreover, no liability attaches to the manufacturer if he has not manufactured the product either for sale or for any other form of distribution for commercial purposes or has not manufactured or sold the product in the course of his business operations. The detailed reasons for this are as follows:

A manufacturer from whom products are stolen does not himself bring them onto the market. In the case of importers, they only introduce products onto the

market on importation into a member state of the European Economic Area; this is significant in that the product must already contain a defect at the time when it is brought onto the market. It can thus not suffice for the importer to claim that the product was free from defects on leaving the manufacturer's premises and he must therefore prove that the product was free from defects at the time of importation. For the manufacturer, this liability exclusion clause means that it is advisable to carry out a careful check on receiving deliveries of part-products and an equally careful check on end products leaving his factory. Moreover, checks on incoming and outgoing deliveries must be adequately documented to ensure that each batch of products can be fully traced. However, this serves only to absolve manufacturers from liability for manufacturing defects, as defects in design and instructions already apply to products before they are brought onto the market.

A manufacturer may also preclude liability if the product was in compliance with mandatory legal regulations on introduction to the market. It is thus not sufficient for such product to comply with the state of the art, as this is never stipulated in binding legal regulations. In addition, manufacturers are not liable for design defects if it was not possible to detect these according to the state of the art. The decisive criterion is the time when the products are brought onto the market. The important factor is not the national state of the art, but whether it would not have been possible to detect design defects since the required technical know-how did not yet exist at the time. Stringent requirements thus apply for exemption from liability for so-called development defects.

The Product liability law provides for special exemption from liability for suppliers. The manufacturer of a part-product will not be liable if a defect in the end product is attributable to its design or other instructions by its manufacturer. Even if the manufacturer of a part-product may be able to avoid liability in this regard, it must always be considered whether he may have rendered himself liable for damages due to his failure to draw the attention of the manufacturer to any design defects.

9. Liability under the Product liability law is in principle *unlimited*, although there are exceptions to this rule. In the case of damage to property, the claimant must himself bear a sum of € 500.00 of the total damages. In this respect, the claimant can only seek damages under the law of tort. For personal injury, damages are limited to € 85 million, irrespective of whether the damage was caused by one product or a number of products with the same defect. If the upper limit of damages is exceeded, the claimant will only have recourse to the general law of tort.

The Product liability law did not initially provide for compensation for non-material damage (compensation for pain and suffering), although this no longer applies following the revision of the legislation. For cases of damage arising after 31 July 2002, reasonable pecuniary compensation may be claimed for non-material damage. Extensive case law has been developed and is now collated in so-called immaterial damage compensation tables.

The Product liability law includes special provisions for personal injury. If someone dies as a result of a product defect, his surviving dependents may claim damages for the assumed duration of his life and of his assumed duty of maintenance

of such dependents. Despite his death, the obligation to pay damages to the claimants for the costs of the attempted medical treatment of the deceased and his losses of income during that period continues to apply. If a person is only injured, he is to be compensated for the costs of his treatment and loss of income, as well as all costs necessitated by the fact that his needs will have increased. As a rule, the losses of income of the injured party and, in the event of his death as a result of a product defect, his surviving dependents will be compensated by means of an annuity, although lump-sum compensation may also be agreed.

10. Claims must be brought within 3 years after the party has discovered or should have reasonably discovered the defect, the damage and the identity of the liable party. But the maximum is in any case 10 years from the date on which the product was brought onto the market. So if you have discovered the defect in the ninth year, you have to file the claim within 1 year.

The manufacturer/importer must prove that all requirements for expiry or time barring of claims under the Product liability law have been met.

11. The provisions of the Product liability law are mandatory and cannot be excluded or restricted in advance. This applies even if a different arrangement has been reached by mutual agreement prior to the damaging event. Once the damaging event has occurred, agreements diverging from the Product liability law may be reached.

3 The Law of Tort

Liability for defective products also arises under the Law of Tort, as the Product liability law does not constitute a conclusive regulation. Anyone intentionally or negligently causing an unlawful impingement upon the life, physical person, health, freedom, property and/or other rights of another is liable under the law of tort. The essential differences between the Law of Tort and the Product liability law are explained below.

1. Under the Law of Tort, the manufacturer of a defective end product or part-product is liable, including anyone purporting to be the manufacturer. It must be emphasised at this point that under certain circumstances the responsible *representatives* of the manufacturer, such as the manager responsible for production, may be held personally liable. Liability does not apply on principle to *importers* and *dealers*, with certain exceptions. A dealer may be held liable if for instance he fails to check products prior to introducing them to the market despite being aware that there may be associated risks in terms of their quality. A particular obligation to monitor products also applies to dealers selling the products of a manufacturer based abroad. The dealer is required to undertake after-sale monitoring of such products in order to ensure that any inherent risks are detected in good time and brought to the attention of the foreign manufacturer.

2. As with the Product liability law, under the law of tort compensation is only to be provided for *material damage* affecting other property than the defective product. However, property in commercial use is also compensable, unlike product liability law.
3. While the Product liability law provides for no-fault liability, claims under the Law of Tort require specific *fault* and the manufacturer must have acted in breach of his duty to ensure that his products are safe for public use. As under the Product liability law, breaches of the duty of care may be attributable to defects of design, production or instruction. Liability thus does not apply to so-called one-off rogue items, which are unavoidable despite all reasonable precautions. However, the Product liability law applies in such cases. With regard to the aforementioned categories of defect, the manufacturer also has organisational obligations and is required to organise his business operations in such a way as to ensure that defects can either be precluded or identified in good time. The manufacturer should maintain precise documentation in view of the apportionment of the burden of evidence. He must also monitor his products after sale to ensure that any associated risks are detected and any potential damage avoided. These product-monitoring requirements also apply to importers as explained above.
4. In contrast to the Product liability law, the Law of Tort does not provide for any *maximum limit of liability* for personal injury.
5. As with the Product liability law, the claimant must as a matter of principle provide *evidence* of the defect, the damage and their causal connection. Case law has nevertheless also been developed under the Law of Tort providing certain relaxations of the burden of evidence, up to and including reversal of the burden. If it is established that the damage was attributable to a product defect, the manufacturer must prove that it had no fault. The requirements in this regard are extremely strict and may under certain circumstances require the manufacturer to furnish evidence in exoneration of anyone involved in the manufacture of the defective product.

4 Law of Contract

Liability may also apply for defective products under the Law of Contract, in which case not only may a consumer bring a claim for damages under contract, but both dealers and the manufacturer are mutually liable if and insofar as they are both bound by contract. Equally, anyone purporting to be a manufacturer in dealings with his contractual counterparts is liable in the same way as a manufacturer.

For claims for damages to be brought based on contract the damaging party must have acted in breach of a duty and be answerable for such breach. In terms of defective products, a breach of duty is deemed to arise on delivery of such products. The damaging party is generally required to prove that he is not responsible for the breach of duty, although a distinction is again to be made in this context between the manufacturer and the dealer of a defective product, as there is no fundamental

requirement for a dealer to check a product prior to sale to ensure that it has no defects. However, this does not apply if there are indications apparent to the dealer that the product may be defective. A dealer will thus generally be able to exonerate himself of responsibility to his contractual counterparts, whereas this is considerably more difficult for the manufacturer of an end product or part-product.

The ability to bring claims for damages under contract is of particular significance for the claimant, as pure pecuniary damage is also subject to compensation. Thus, for instance, damages may be claimed for business interruption without the need for prior damage to property and/or personal injury.

5 Equipment and Products Safety Act

1. The Equipment and Products Safety Act of 6 January 2004 is based on European Directive 2001/1995/EG on general product safety, which came into force on 3 December 2001. That Directive establishes general product safety requirements with a view to harmonising the level of consumer protection in the member states. The Directive was adopted into German Law in the Law Reforming the Regulation of Safety of Technical Working Materials and Equipment and Consumer Products of 6 January 2004. The Equipment and Products Safety Acts forms part of this legislation and regulates the governmental supervision of the market for technical working materials and equipment and consumer products. It prescribes general product safety requirements and empowers the market supervision authorities to take action in cases where these product safety requirements have not been met.
2. The Equipment and Products Safety Act is subordinate to special product-related laws, such as the Chemicals Act, the Medical Products Act and the Pharmaceuticals Act, which provide for more stringent product safety requirements. As a general product safety requirement, the Equipment and Products Safety Act states that the health and safety of users or third parties must not be jeopardised by either the prescribed use of the product or its reasonable incorrect use. Over and above these general product safety requirements, special safety requirements as laid down in European and/or national safety regulations must also be met. Products complying with these special safety regulations are expected to meet all requirements in terms of health and safety. The decisive time for the assessment of safety is the date on which the product was first brought onto the market within the European Economic Area.
3. The Equipment and Products Safety Act applies to *manufacturers, agents, importers and dealers*.

On introducing a product to the market, manufacturers are required to furnish the user with all information necessary to avoid damage in the form of instructions for use. Manufacturers, agents or importers are also required to identify themselves on the product, in particular by providing their address, unless the application of such information to the product would entail unreasonable expenditure. This also

applies to the product marking; consumer products must be adequately marked to ensure that they can be identified, for example by means of a type or serial number. This serves to ensure that defective products can be *properly traced back*. Manufacturers, their agents and importers must also make arrangements permitting the withdrawal or recall of consumer products, which obliges in particular manufacturers to make provision for effective risk management. Once products are brought onto the market, manufacturers, their agents and importers are required to monitor the market, for instance by carrying out random-sample checks and investigating complaints. In particular, they are required to notify the market supervision authorities of any health and safety risks arising in connection with consumer products and to confirm to the authorities what measures they have adopted to avoid such risks. For their part and irrespective of any risks notified to them, the market supervision authorities may on detection of such risks order that the products be withheld from the market or that products already in circulation be *withdrawn* or *recalled*. All orders by the market supervision authorities are issued to the manufacturer, although they may also subsequently be issued to dealers if the risks cannot otherwise be precluded.

Real-Estate Property Law Germany

C.R. Wolf

1 Real-Estate Property

1.1 The Concept of Real-Estate Property in German Law

The concept of real-estate property is not legally defined in German law. From the statutes concerning real-estate property, it can be determined that real estate in the legal sense is a specially limited portion of the face of the earth which is recorded in the land register. The land registers are maintained by the local courts. Several pieces of real estate belonging to the same owner can be contained on a single page (for more details concerning the land register see Sect. 4 below).

In addition to the land register, a cadastral map illustrating the land-share divisions (“Liegenschaftskataster”) is maintained. The entire surface of the earth within the state territory is surveyed and divided into local sub-districts, units and lots, which are recorded in the cadastral map. The land register and the cadastral map of land shares must be kept in such a way that they match perfectly. This is ensured through the notification of the land registry of any changes in the status quo or in the definition of the cadastral units by the land-survey office (“Katasteramt”). The cadastral map of land shares thus contains detailed information about the actual proportions of a piece of property and the land register contains the legal description.

1.2 Principle of the Oneness of Real-Estate Property and Buildings Located Thereupon

Under German law, any buildings firmly attached to the ground and soil upon which they stand are considered to be integral parts of the real-estate. The ownership of the buildings rightfully belongs to the owner of the land and cannot be separated from it. The sale of real-estate thus always includes the building located on it; it is not possible to sell the building without the land.

The legal situation in the former GDR was fundamentally different. There it was both possible and widely common to procure ownership of a building only,

whereas the property on which it was located was simply leased. This regulation was retained in the course of the reunification of the German states. In the new federal states of Thuringa, Saxony, Saxony-Anhalt, Brandenburg, Mecklenburg-Pomerania and the eastern portion of the city-state of Berlin, the concept of independent ownership of buildings still exists. However, this regulation is limited to property previously divided in such a manner; it is most definitely not the rule of thumb in the post-reunification reconstruction efforts. In the present cases, the land and the building located on it are each registered on separate pages in the land register.

2 Real-Estate-Similar Rights

2.1 Condominiums and Part Ownerships

In addition to total ownership of real-estate property, there exists condominiums and part ownerships of property. In the latter cases, the owner has a fixed partial ownership share in a jointly owned piece of real-estate in addition to sole ownership of an apartment located on the property, or a part of a building that is separate and complete in itself and not used for residential purposes.

Particularly large apartment buildings, some of which have several hundred residential units, are erected in the form of condominiums. The advantage of condominiums is that they can be sold and mortgaged, together with a percentage share of the jointly held property.

Condominiums are special forms of real estate ownership and in many cases are treated the same way as regular real estate. Every condominium, for example, has its own page in the land register.

2.2 Building Right of Inheritance

A further real-estate-right is the heritable building right (“Erbbaurecht”). This is a transferable right to erect a building on or under the ground surface of a piece of property. There is a special land register for such rights. In addition to the independent ownership of a building (without the ownership of the property it is built on) in the new federal states, this is the second exception to the rule that the ownership of a building automatically belongs to the owner of the real estate. Here the building is an integral part of the inheritable building right. This right is in many ways comparable to a long-term lease and requires its bearer to pay an annual leasing fee. It continues to endure insofar as it can be independently charged with mortgages, liens and other real-estate encumbrances.

The heritable building right offers both the property owner and the entitled party advantages in that it enables the owner to achieve ongoing yields from the property without having to sell it. The bearer of the heritable building right has the right to erect a building without having to pay a high purchase price for the land. Heritable building rights are thus often issued by churches or communities to promote social welfare housing projects. Heritable building rights are generally granted for a duration of time ranging from somewhere between 30 and 99 years. After the elapse of that fixed period, the right expires with the result that the owner of the land automatically becomes the owner of the building and must provide adequate compensation to the former bearer of the right. The land owner can avoid this compensation obligation by offering the bearer of the right the possibility of extending his title for a further period of time that would approximately correspond to the predicable lifetime of his building as it currently stands. If the bearer of the title declines such an extension proposal, he loses his lawful compensation claim.

3 The Purchase and Sale of Real Estate

The purchase and sale of real estate requires notarization (see Chap. Notaries in Germany, Sect. 2.1). The transfer of property, however, does not occur solely through the finalization of the notarial contract, but when the new owner is noted in the land register. Before that registration occurs, the purchaser simply has a claim to the property arising from the notarial contract.

The change of ownership cannot be noted in the land register until the notary has procured all the required official permits to enforce the contract, the community in whose jurisdictional influence the transaction lies has waived its pre-emptive rights to buy the property and the purchaser has paid the property tax at the rate of 3.5% of the purchase price. This procedure generally takes several weeks or months. In the meantime, the purchaser's position is still not completely secure. However, there exists the widely used possibility of securing the property rights of the purchaser in advance by way of a priority notice ("Vormerkung") in the land register. This priority notice basically amounts to a reservation for the purchaser which protects him against any attempts of the seller, who is still the registered owner of the property, from disposing of it in another fashion as well as against interventions by any creditors of the seller.

Appendix:

Permit Requirements for the Purchase of Real Estate by Foreigners

The German External Trade Act ("Außenwirtschaftsgesetz") provides for the possibility of making real-estate transactions with foreigners subject to the issuance of permits. No use has yet been made of this state authority which would apply to both natural persons and legal entities. Foreigners and foreign companies can thus currently purchase property in German with no restrictions whatsoever.

4 The Land Register

4.1 *The Five Parts of a Land Register Page*

Every page in the land register consists of five parts: the inscription, the itemized description of the current features of the property and Sections I–III. The inscription contains the names of the municipal court, the land register district and the number of the land register page. If the page has been prepared for a condominium or a heritable building right, it contains the additional label “Wohnungsgrundbuch” (“Land Register for Condominiums”) or “Erbbaugrundbuch” (“Land Register for Building Leases”). The itemized description of the property shows the current state of the property and any changes to it that have been made in the past. Every piece of property receives a successive number. Reference is made to this number whenever further entries are made. If any changes arise through a division of the property, the newly created pieces of property are registered under the successive numbers and the former piece of property is underlined in red. This “red pencilling” makes it clear that the piece of property so marked no longer exists. The itemized list of the features of the property also contains the dimensions of the property.

In Section I of the land register, the owner or owners of the property are identified as well as the legal grounds for their acquisition of it. In cases involving more than one owner, the nature of the joint relationship is also registered – for instance, “co-owners” or “GbR” (“civil-law partnership”). Sections II and III of the land register contain the registration of the encumbrances on the property, whereby mortgages (bank mortgages, land charges and annuity charges) are listed in Section III and all remaining encumbrances and restrictions are listed in Section II. The division into two sections here is merely a historical remnant – it would be the same if all the property encumbrances were listed in one section (for more about each of the different types of property encumbrances see Sect. 5 below).

Since the content of a property encumbrance is often extensive and detailed, the right is merely registered in abbreviated form. For further information concerning the content of the right, reference is made to the files kept by the land registers in which all of the documents pertaining to a given piece of property are put into archives. In order to find out what the right in total entails, it might be necessary to gain access to the land register files (“Grundakten”).

A right is deleted through “red pencilling” and the registration of a cancellation note. Any alternation of the right is likewise registered.

Presently the land registers become converted into electronic registers. Such projects are already underway in the most federal states. Notaries are directly networked to the electronic land registers, which gives them on-line access to the files.

4.2 Access Rights to the Land Register

Anyone who can demonstrate a legitimate interest in the matter is granted permission to inspect the land register. The right to look into the land register also encompasses the right to inspect the land register files. Any submitted but not yet registered applications as well as copies or certified copies of pertinent entries in the land register or of documents contained in the land register files may be obtained with payment of the copying costs.

The question of what exactly constitutes a “legitimate interest” has been the object of various judicial decisions. From these decisions it can be deduced that legitimate interest exists when enough facts can be presented to convince the land registry that access to the files is not desired for abusive purposes or out of pure curiosity. Here data protection has priority. A person with a legitimate reason for wanting to gain access to the records could be, for instance, a potential buyer in the process of concretely negotiating the purchase of the property with its owner, but not a prospective buyer who wants to get the name of the property owner by inspecting the books first.

Notaries are exempted from having to prove legitimate interest and thus have free access to all land registers.

4.3 Public Faith in the Land Register

The registration of a property right in the land register is a prerequisite to ownership. Therefore, there is a high degree of probability that any right registered in the land register actually does exist. Yet there are exceptional cases involving errors in the land register, for instance, when the agreement that provided the bases for the entry never came into effect. Registration in the land register is indeed a prerequisite to ownership, yet it alone is not enough. Without a valid agreement between the property owner and the otherwise entitled person, no right of ownership has originated, not even if it has been entered in the land register.

Another way in which the land register can become inaccurate is through the death of a registered owner. Upon the death of a property owner, the complete estate and therewith ownership rights to any real-estate property are automatically transferred by force of the law to the heirs. In such cases the land register has to be updated.

All persons, who are involved in legal transactions, however, should be able to assume even in such cases mentioned above that the entries in the land register are correct. Par. 891 of the German Civil Code (“Bürgerliches Gesetzbuch” [BGB]) establishes the legal premise for assuming that the land register correctly and completely reflects the rights to the property. This statute causes one of the oddest quirks in the entire German land registration system because the presumption of

correctness gives way to yet a further legal effect entailing the protection of a purchaser who acted in good faith. A person who buys a piece of real-estate property from the person listed as its lawful owner in the land register, but who in fact is not the owner, lawfully acquires that property as long as he was fully unaware of the inaccuracy of the land register.

Just as the legal relations may rely on the existence of registered rights, they may rely on the non-existence of non-registered rights. If, for example, a mortgage or a land charge has been improperly extinguished, it is not possible to assert to a subsequent purchaser of the property that the right in fact exists. The only recourse of the actual holder of such a right, provided the property was acquired in good faith, is to sue the land registry for the compensation of losses stemming from its negligence.

In cases in which a non-owner of a piece of property is still registered as its lawful owner in the land register, *the good faith of the acquirer is protected. But the seller must not obtain the purchase price.* For instance, the non-entitled seller of the property must turn the proceeds over to the actual owner. The actual owner, on the other hand, cannot demand return of the property from the acquirer who acted in good faith.

The public faith in the German land register results in a very high degree of reliability in real-estate transactions. This is particularly true and important for mortgage liens, since the lender can rely on the entries in the land register.

4.4 Priority Ranking in the Land Register

4.4.1 The Priority Ranking Among Various Rights Listed in the Land Register

If real-estate is encumbered by various rights against it, these rights are listed in the land register in terms of a specific priority ranking. The priority ranking of the rights listed in one and the same section of the land register is determined by the order of their registration. If the rights are listed in different sections, their priority ranking is determined by the dates on which they were registered. Rights that were registered earlier have priority over those that were listed later. If any rights were registered in different sections on the same day, they have identical priority among themselves. In the event that any rights in the same section gave identical priority ranking, this is noted next to each of the rights effected.

The order in which the land registry must register various rights is determined by the dates on which the applications for registration were filed with the land registry. Every application for registration is precisely dated by the land registry in terms of the day and hour that it was received. The rules of procedure regulate that the land registry must enter the applications into the land register in precisely the order that is determined by the reception data contained in each of the applications. Of decisive importance here is not the date of registration but rather the date on which the application was filed. If several applications are filed at the same time,

they have equal priority. Other rules apply only if a priority designation is affixed to the several applications that were filed together. The parties to a transaction involving several rights to be registered in the land register can thus agree in advance to their priority ranking during the notarial recording of the transaction or at the time when the rights are certified before the notary. The notary will then pass that priority ranking on to the land register, which will register the rights according to the determined ranking.

It is also possible to change the priority ranking freely at any later date. This presupposes, however, that those entitled to the registered rights and the property owner are in accord concerning the priority ranking and agree to have the change made accordingly in the land register. Such a change in the priority ranking may not entail an improvement or worsening of the status of any other rights contained in the land register.

4.4.2 Significance of the Priority Ranking

The ranking of a right contained in the land register is of prime significance for its value and security. It determines the consideration order and the chances of having the right satisfied in the event that the encumbered piece of property has to be put up for public auction. The priority rights of a creditor forcing the public auction cannot be impaired. After the “fall of the hammer”, they still remain as an encumbrance upon the property. On the other hand, any rights that are lower in priority than the rights of the creditor enforcing satisfaction expire with the public auction. Therefore, when it comes to auctioning off the property, higher priority ranking results in greater rights. For that reason, credit institutions interested in securing a loan by having a land charge or mortgage noted in the land register tend to insist upon having top priority ranking. They are willing to accept a worse standing only if the market value of the property is so high that, even in the event of a public auction, the creditors registered in second place or even lower are guaranteed satisfaction of their claims.

Public faith in the accuracy of the land register (see Sect. 4.3 above) also plays a role in the priority of a registered right. Should a right be noted in the wrong order in the land register, a third party acting in good faith acquires the right as it stands in the land register.

5 Rights to Real-Estate Property

5.1 Compulsory Form of Real-Estate Property Rights

Not just any kind of rights and limitations that the parties to a real-estate deal might agree to can be entered into the land register as encumbrances, but rather only those that the statutes provide for. Due to the lack of statutory regulation, it is not possible

to enter, for example, any rights to rent or lease in the land register. Thus, if an application is filed by the parties for registration of a right not provided for by statute or for registration of a right provided for by statute and has been endowed with impermissible content, the land registry must reject the application.

5.2 *Rights of Section II (Selection)*

5.2.1 *Usufruct of Landed Property*

Real-estate property, as well as condominiums and heritable building rights can be charged with a so-called usufruct (“Nießbrauch”). The usufruct grants the entitled party the right to take the property into his possession and make full use of it. In other words, the usufructuary is entitled to the personal use of the property as well as to any and all yields of the property such as renting and leasing yields.

The usufruct is frequently used in the form of a so-called proviso usufruct (“Vor behaltsnießbrauch”), if property is to be transferred to the next generation by persons still living, who wish to reserve their rights to use the property themselves until they have deceased. This is in Anglo-American law known as reserving a life estate in property with remainder to the heirs.

5.2.2 *Easements (“Dienstbarkeiten”)*

Easements are limited in rem rights to a piece of property aimed at toleration or omission. For the most part, they serve the maintenance of good neighbourly relations, the enforcement of building rights and now, particularly, the securing of competitive interests. Examples of easements are the granting of the right to passage or the right to lay a water pipeline through the property, building restrictions on the property, tolerance of less than the normally required distance of a building on the neighbouring lot or the tolerance of emissions from a neighbouring lot.

There are two types of easements, the so-called “basic easement” (“Grunddienstbarkeit”) and the “limited personal easement” (“beschränkte persönliche Dienstbarkeit”). The basic easement is not a right belonging to the entitled person himself but merely in his capacity as the owner of the entitled piece of property. The current owner of the property has a claim to this right as well as any other parties that might own the property in the future. The basic easement is thus passed on to the new owner as an integral part of the property when it is sold.

The limited personal easement belongs to a specific natural person or legal entity. Such an easement is attached to the individual person who is entitled to it. It is neither heritable nor transferable. It is merely possible to let a third party exercise the right insofar as the owner permits. The limited personal easement is frequently ordered in the form of a right to tenancy (“Wohnungsrecht”), which guarantees the seller of the property the continued right to use it until his death.

5.2.3 Land Liens Conveying the Right to Recurrent Payments or Services (“Reallast”)

The “Reallast” type of land charge is the method provided by law for the securing of legal debts and obligations through recurring (?) payments, payments in kind or services. The essential content of such a land lien is thus the obligation to give or to do a specific thing. The payments can be in money, in kind or in the form of services. The payments must, however, be recurring. A one-time payment cannot be the object of such a land lien.

The payment obligations arising from such a land lien also have to be defined or definable, so that entitled persons with lower priority can determine the capacity the higher ranking lien would have in a public auction. Accordingly, the content of such a land lien can be periodical payments of a certain amount of money (“Geldrente”) or care services. This right is mainly used by owners of property in order to secure their rights when transferring the property in anticipation of the succession to it by inheritance. Yet another important use of this right is to secure leasing payments for heritable building rights (“Erbbauzins”) [Compare Sect. 2.2 above].

The payment obligations secured by such land liens can but must not necessarily be made through the fruits of the charged property. An obligation to make periodic monetary payments can be secured by way of a “Reallast” land lien even when the charged property produces no yields. The sole purpose of the land lien is to grant the entitled person the right to force a public auction of the property in the event that the promised recurring payments are not made and to, thereby, satisfy his claims from the auction proceeds according to the value of the payments due him.

5.3 Real-Estate Mortgages (Rights in Section III)

5.3.1 Definition and Types of Real-Estate Mortgages (“Grundpfandrechte”)

Real-estate mortgages are liens (“Pfandrechte”) against property. They serve to secure personal payment obligations, especially within the context of loan contracts. In most normal cases the debtor and the liable owner of the property are one and the same person. However, it is also possible to secure an obligation of a third party through a property mortgage, for instance, when a business loan of the husband is secured against a piece of property that is solely owned by the wife.

German law recognizes as mortgages the common mortgage (“Hypothek”), the land lien (“Grundschuld”) and, as a subcategory of the land charge, the land lien conveying the right to periodic payments (“Rentenschuld”). The last form is of practically no significance. A common mortgage and a land lien both pursue the same objectives. The coexistence of the two forms can only be explained historically. Differences exist insofar as the common mortgage can by force of law originate and continue to exist only in the amount of the claim that is to be secured and only for as long as the claim continues to exist. On the other hand, the land lien is

not dependent on the existence or the amount of the claim that is to be secured through it, as the land charge is abstract. For all practical purposes, this freedom of the land charge from the existence of the claim to be secured is virtually never asserted, since the land charge and the claim are always tied together in the security agreement. In practice, the legal impacts of the common mortgage and the land lien hardly ever display any differences. Today the land charge is predominantly chosen and the common mortgage still shows up occasionally. The banking industry in particular, exclusively uses the land charge to secure property loans.

The legal impact of the registration of a property mortgage is that the registered creditor is entitled to enforce public auction of the property in order to satisfy its claims in the event that the debtor's payments are overdue. The liability of the property owner is his risk of losing the property by way of public auction.

5.3.2 Economic Significance of Mortgages

The significance of mortgages in Germany in terms of the public economy is enormous. At the end of 1994, loans amounting to a total of € 0.6 trillion were secured through mortgaged loans on housing property alone.

The preference for securing loans through mortgages on real-estate property vs. other types of collateral such as third-party endorsements or liens against moveable goods rests primarily on the following three factors:

- The long-term value continuity of property assets
- The public nature of the land register in which it can immediately be seen who the property owner is, who the creditors are and what priority rankings the creditors have among themselves and
- The good-faith protection guaranteed by the land register.

5.3.3 Subjection to Immediate Enforcement

In the case of land lien to the benefit of commercial lending institutions, an agreement to immediate enforcement is generally made in the amount equal to the mortgage. This enables the creditor uncomplicated access to the assets of the debtor who has fallen behind in his payments without complex and lengthy court proceedings (compare Chap. Notaries in Germany, Sect. 3.2).

5.3.4 Personal Assumption of Liability

In addition to ordering mortgages, commercial lending institutions generally tend to demand that anyone given a property loan has to assume personal liability for the repayment of the loan with all remaining personal assets. Subjection to immediate enforcement occurs here as well. The financing institution thus secures its interests not only through the mortgaged real-estate property, but through the entire personal assets of the debtor.

The Law of Insolvency and Security Interests

R. Nacke

1 Introduction

Section 1 of the German Insolvency Act defines the comprehensive goal of the insolvency procedure as the satisfaction of all the claims of a debtor's creditors jointly, by either realizing the assets of the debtor and dividing the proceeds or by reaching a divergent arrangement, whereby the business continues to exist.

Responsibility for the achievement of the goal is first and foremost the insolvency court and the insolvency administrator appointed by the court. In addition, there is often a Committee of creditors (Gläubigerausschuss) appointed.

How and under which legal conditions the mentioned institutions pursue the objectives defined under Section 1 of the Insolvency Act is the subject of this article. Sections II–IV describe the normal insolvency procedure, Section V describes a special insolvency plan procedure (equivalent to composition proceedings), and Section VI outlines the provision concerning the discharge of remaining indebtedness. This provision allows natural persons who have been declared bankrupt to be released from their remaining liabilities, if they agree for a definite time period to assign a substantial part of their future wages or salary to creditors. Section VII contains a brief description of the legal situation in cases where the debtor has property not only in Germany but in other countries as well.

2 Steps Leading to the Institution of Insolvency Proceedings/Security Interests

2.1 Steps Leading to Insolvency Proceedings

Insolvency proceedings may be instituted against the property of a natural or legal person through the granting of a court order issued in response to a petition filed either by one or more creditors or by the debtor himself.

As a rule, the pre-requisites for such a court order instituting insolvency proceedings include: (1) current insolvency (inability to pay one's debts) or (2) if the debtor

applies for insolvency also impending insolvency (the expected lack of liquid resources necessary for paying one's debts). In the case of legal persons, the court may also grant an order initiating insolvency proceedings in the case of (3) excessive indebtedness. Excessive indebtedness exists if the liabilities of the business exceed the value of its assets. This excessive indebtedness is not shown by the normal financial statement. Rather, the determination is made with the help of the so-called "Überschuldungsbilanz" (excessive indebtedness balance). The basis of this special financial statement may, however, be the normal commercial balance sheet. The primary difference between the commercial balance sheet and the excessive indebtedness financial statement is that, in the latter, it is very important to properly reflect the true value of the business's assets and liabilities. The assets are valued with their real value, which often deviates from their book value. Therefore, in preparing the excessive indebtedness financial statement, a decision must be made whether property shall be valued according to its liquidation value or according to the "going concern" principle. Which method is used depends on whether a business analysis indicates a positive or a negative prognosis. If the business is not able to continue in existence, then the liquidation value will be used. Otherwise, the "going concern" method of valuation should be employed.

The manager of a legal person has a difficult task because he is required by law to file a bankruptcy petition as soon as the business is insolvent or has excessive indebtedness. Whether a business is insolvent is difficult to ascertain because this prerequisite is not fulfilled with only temporary lack of means to pay the company's debts. In order to meet the legal obligation concerning over-indebtedness, the managing director must, as a practical matter, begin to prepare an excessive indebtedness balance on a monthly basis as soon as the business finds itself in a financially critical phase. If the manager of the business fails to file a bankruptcy petition when required, he often is held liable for civil damages.

Prior to the official institution of insolvency proceedings, the appropriate Local Court decides whether the petition for the institution of bankruptcy proceedings shall be initially accepted. Venue is not only determined by the official domicile (registered office) of the business, but also according to where the business conducts its economic activities. Therefore, efforts of a debtor to influence the choice of judicial forum by relocating the business's registered office or domicile are generally ineffective.

If the petition for the institution of insolvency proceedings is initially accepted, the Local Court will issue an order prohibiting the creditors from pursuing execution or enforcement actions in moveable assets, and will appoint a provisional insolvency administrator. Frequently, the debtor will be prohibited from managing his property. Such management rights will be transferred to the provisional administrator.

The provisional insolvency administrator has the following duties:

- To protect and preserve the property of the debtor
- To carry on the business for the time being unless the court has ordered its closure
- To determine if the assets of the debtor are sufficient to cover the costs of the insolvency proceedings

2.2 *Security Interests*

In particular, this last duty means that the provisional insolvency administrator must determine if the unencumbered assets are sufficient to cover his own expenses as well as his compensation. Still, an uncountable number of applications for the institution of insolvency proceedings are denied, and the basis for this denial is an insufficient amount of unencumbered assets. The reason that debtors often possess so few unencumbered assets is the extensive use of security interests in Germany. Hardly anywhere in the world do such far-reaching and commonly used possibilities exist for the supplier to secure the payment of an unpaid purchase price.

As a first step, the supplier does retain ownership rights in the delivered product. In addition, it is common for the supplier to secure in advance a security interest in the products that are to be produced with the help of the delivered product. Further, suppliers typically require the debtor to assign to the supplier all accounts receivables which result either from the sale of the supplied product or from the sale of the product which the debtor has produced with such product (extended reservation of title). According to the standard business terms often added to contracts, the supplier further does not lose his security rights with the payment of the purchase price of the respective products. Rather, such rights are extinguished only at the point when all claims against the buyer have been satisfied or when the value of the supplier's security greatly exceeds the value of his underlying claims.

Similar to the supplier, the bank which has provided financing also secures its loan by obtaining a transfer of ownership rights in business assets or assignment of the debtor's accounts receivables.

Unlike in most countries, the creation of security interests in personal property neither requires certification by a notary nor registration. Rather, sellers and buyers or banks and debtors create such interests through contracts which incorporate standard business terms. Notarization as well as registration is only required in order to obtain security in real property through a land charge or mortgage. Although standard business terms are sufficient, they should be drafted with care, because otherwise the intended effect can easily be missed (see III.B.).

The creditor who holds one of the above referenced security interests in principle has in some cases the right to demand surrender of his property from the insolvency administrator (screening, e.g., in case of reservation of title). However, the court may decree that the insolvency administrator is entitled to reject such a demand in order to continue the business in cases where the respective item is of significant relevance for the continuation of the business. In any event, the insolvency administrator is obliged to satisfy a secured creditor's claim before the satisfaction of other creditors' claims (preferential treatment).

In case of goods delivered to the debtor under reservation of title, the administrator can return the goods for the seller or can keep the products for fulfillment of the purchase contract to continue with the business. In this case, he must pay the full purchase price to the seller (see below IV.E).

In case of preferential treatment, the insolvency administrator satisfies such preferred creditors claims either out of the resulting proceeds of his sale of the secured

property or out of the accounts receivables associated with such property which he collects. Above all the latter becomes practicable if the debtor, in case of an extended reservation of title supra second break has sold the supplied product or if he has processed and then sold the result of the processing. The administrator in such cases will collect the purchase prices from the customers of the debtor and pay the outcome to the creditors after deducting 9% fee for his efforts.

2.3 Negative Result of the Preliminary Investigation

When the insolvency administrator to a large extent finds such secured goods in the above described ways, hardly any value is left over for distribution to the remaining creditors or to cover the costs of the insolvency proceeding. One provision which helps to ensure that at least some value exists, however, is the requirement that 9% of realization proceeds from property obtained through the efforts of the insolvency administrator must be allocated to the insolvent's estate.

If the provisional insolvency administrator determines that the debtor does not possess sufficient unencumbered property to cover the costs of the proceedings, he will recommend to the court that it deny the petition for the institution of bankruptcy, unless a creditor exists who is willing to provide an advance to cover the foreseeable costs. A creditor will only consider making such a payment if the insolvency administrator, given his economic expertise and his understanding of the debtor's circumstances, is in a position to at least recover and pay to the creditor a portion of the claim which such creditor stands to lose.

If the petition for institution of bankruptcy proceedings is denied and execution becomes possible, a creditor may attempt to achieve payment of his claim by way of a separate execution action. However, in conjunction with denying the petition to initiate bankruptcy, the court in the case of a bankrupt legal person will order it struck from the commercial register with the result that such business no longer exists.

3 Order of Events in the Insolvency Proceedings

3.1 Institution of the Proceedings

If the court, based on the opinion of the provisional insolvency administrator, determines that the debtor has sufficient assets for the institution of bankruptcy proceedings, then it shall issue an order initiating such proceedings. The court appoints an insolvency administrator. If the debtor himself wishes to handle the further proceedings, the court will appoint him, if it comes to the conclusion that this has no adverse effect on the proceedings. The court in this case must appoint a person whose role it is to supervise the debtor's transactions.

At the same time, all creditors are given a certain amount of time to present their claims to the insolvency administrator and reveal all of their security interests and rights in the property of the debtor. All persons with claims are required to seek relief only from the insolvency administrator instead of the debtor (see IV.B.).

In addition, the fact that bankruptcy proceedings have been instituted is publicized in the Internet (<http://www.insolvenzbekanntmachungen.de>).

3.2 Collection of Assets by the Administrator

As previously mentioned, determining the assets is one of the duties of the insolvency administrator. For this purpose he can alienate the entire company by means of asset deals which could possibly bring the proceeding to a fast end. However, he also can proceed with the business operation himself, or he can cease operations and primarily concentrate to assert the debtors claims against customers, shareholders and managing directors and to wind-up the debtor.

With regard to limited liability companies (GmbH + AG as well as GmbH & Co. KG) he shall at first check whether the nominal capital has been fully paid in, whether loans granted to the company by shareholders have been re-paid to shareholders within the last year prior to the filing of the petition for the institution of insolvency proceedings or whether some creditors have received preferential treatment before others by payments during the past few months prior to the opening of the insolvency proceedings (also the house bank, e.g., by customer payments into an account showing a negative balance), etc. All this leads to claims of the insolvency estate, and the administrator will, in the first instance, assert those claims extra-judicially and, if necessary, enforce the claims by court action. This explains why insolvency proceedings in most of the cases take years.

3.3 Announcement of Claims, Surrender of Property

Typically, creditors file their claims through use of a special form which the court provides. Although a creditor can personally handle the filing of a claim, most creditors secure an attorney to represent them in the announcement of their claim. In this way, the creditor ensures that he has an attorney who is familiar with the issues in case the insolvency administrator fails to recognize the claim(s), and it becomes necessary for the creditor to take legal steps to enforce such recognition. In spite of the denial of the claim through the insolvency administrator, an action for allowance of the claim is not necessary if the creditor already has an executory title (e.g., a judgment). If the debtor still contests the claim, he and not the creditor has to institute legal proceedings.

Attorney representation is also advisable for those creditors with security interests in the debtor's property. Such a security interest can arise, for example, when the creditor delivers property under a reservation of title or provided credit under

the condition that he be granted a lien in the debtor's property (see II.B.). If a creditor's claim is secured, it is not only necessary to correctly announce one's claim, but care must also be taken to ensure that the property which is owned by the creditor and not the debtor is surrendered by the insolvency administrator. Despite such security, voluntary delivery of the creditor's property is not always forthcoming. It can fairly be said that the insolvency administrator is interested in saving as much of such property as he can for all the creditors, thereby achieving the largest distributive share for each creditor as possible. The insolvency administrator who accomplishes this not only develops a good reputation, but can also command a higher compensation for his services rendered in the proceedings. Thus, the creditor's demand for recognition of his security right is quite often met with arguments by the insolvency administrator against the legal effectiveness of such right, rather than with a easily obtained recognition.

3.4 Committee of Inspection and Creditors' Meetings

In addition to the insolvency administrator, the court often appoints a Committee of Inspection (Gläubigerausschuss) consisting of representatives of creditor groups (i.e., creditors with claims of relatively greater value, creditors with claims of lower value, employees, etc.). The Committee of Inspection supports and oversees the actions of the insolvency administrator.

In addition, the creditors as a whole may decide important issues in a creditor's meeting to which all creditors are invited (Gläubigerversammlung). Such decisions include discharge of the insolvency administrator, the appointment of his replacement, the closure of the business or its continued operation.

3.5 Distribution of Property to Creditors and Conclusion of the Proceedings

When the insolvency administrator has essentially brought the insolvency proceedings to an end, he presents the court with a recommended list of the amounts that each creditor shall receive. Upon receipt of the court's approval, the property of the debtor is distributed. Following this distribution, the court declares the proceedings to be concluded.

To the extent claims of creditors have not been satisfied, and assuming the debtor has any remaining property or income, creditors can file an execution or enforcement action against the debtor in an attempt to recover their claim. However, such execution or enforcement actions are not possible if the debtor has been granted a discharge of all his remaining liabilities (see I above and VI below). From a legal standpoint, creditors can (and assuming their claims are not barred by the

statute of limitations) always pursue their unsatisfied claims against a legal person because legal persons are not entitled to a discharge of remaining liability. All claims which were recognized in the course of the bankruptcy proceeding remain enforceable for 30 years against any future property acquired by a legal entity. However, from a practical standpoint the possibility of property acquisition by a bankrupt company is not very large, since, as the result of the insolvency proceedings, the company has been struck from the commercial register and, therefore, is no longer permitted to operate as a business.

4 Effect of the Institution of Insolvency Proceedings

4.1 *Legal Actions*

The institution of insolvency proceedings results in a suspension of all lawsuits which have been brought by or against the debtor. In the insolvency administrator's discretion, however; such actions can be pursued by the insolvency administrator. In addition, if the action involves certain rights of the creditor, such as a claim for the debtor's surrender of secured property, the creditor also is entitled to continue the lawsuit.

4.2 *Enforcement/Execution*

No individual creditor may execute upon the debtors property during the course of the proceedings. This does not apply to execution actions undertaken based on certain types of liability claims, which arose due to acts or omissions of the insolvency administrator.

4.3 *Offsets*

Creditors may not offset their claims against the debtor's claims during the insolvency proceedings, unless the creditor would have been able to do so prior to the institution of such proceedings. This means, for example, that a creditor is not permitted to obtain satisfaction of his claims against the debtor by purchasing goods from the insolvency administrator and then off-setting his claim against the purchase price he had to pay to the insolvency administrator. The offset ban also prevents a debtor of the insolvent business from buying up the claims of the insolvent business's creditors in order to offset them against the insolvent business's claims against him.

4.4 Contesting the Debtor's Prior Transactions

Often creditors deal with the debtor in order to secure property in satisfaction of their claims prior to the institution of the insolvency proceedings. This can occur, for example, through the debtor's gift of money or property to individual creditors, through the debtor's satisfaction of the claims of individual creditors, or through the debtor's grant of security to individual creditors.

The law grants the insolvency administrator the right to contest such legal transactions i.e., the right to demand the return of such money or other property or rights therein. While the laws regarding such contests by the insolvency administrator are quite complicated, it can be said that all steps taken by the debtor for the benefit of a creditor will be critically examined if such steps took place within the 3 month period prior to the filing of the petition for the institution of insolvency proceedings. Such pre-insolvency petition transactions are suspect, even if the creditor is not given exceptional preferential treatment, but only receives what he is entitled to under his existing contract with the debtor. Moreover, even the receipt of security or a satisfaction of a creditor's claim pursuant to the outcome of regular judicial proceedings is subject to contest by the insolvency administrator.

The administrator further can hold the managing director(s) liable for such payments.

Of particular importance in this context is the re-payment of a loan by the insolvent GmbH or GmbH & Co. KG to shareholders. In case such re-payment was effected within the year prior to the filing of the petition for the institution of insolvency proceedings, the administrator may demand respective refund (prospective legal status from June 2008 onwards).

4.5 Delivery of Goods Contracts

The insolvency administrator is not obligated to secure the complete performance of contracts, which, at the time of the institution of insolvency proceedings, have not yet been completely performed by the debtor or the other party. Rather, he has a choice whether or not to demand performance by the contract partner. If the insolvency administrator determines to demand full performance, he must first ensure that the debtor's obligations under the contract are performed by paying the full purchase price. If the insolvency administrator decides to forego fulfillment of a contract, then the contract partner may only demand damages, and in so doing, such contract partner's claim shall be treated like those of a general creditor of the bankrupt person, i.e., such contract party receives (partial) payment only if all the other creditors also receive at least a partial satisfaction of their claims.

The contract party has the right to a timely decision by the insolvency administrator regarding whether or not his contract shall be fully carried out. If the insolvency administrator does not reach a prompt decision in this regard, he loses his

right to demand performance of the contract. An exception exists if the contract partner has sold property to the debtor under a reservation of title to such property (see II.B.). In this case, a longer decision-making period is afforded to the insolvency administrator (Section 107 II of the Insolvency Act). This exception enables the administrator to use that property, at least until he has met a decision whether or not to continue the debtor's business.

4.6 Leases

If the debtor has leased immovable property, then such leases remain in effect after the institution of bankruptcy proceedings. If the debtor has leased space himself, the insolvency administrator has the right to terminate said lease. In so doing, he is entitled to take advantage of the shortest notice of termination period allowed by law.

4.7 Employment Contracts

The earnings of employees for the last 3 months prior to the institution of the insolvency proceedings are guaranteed to be paid, because the law grants all employees the right to payment of these earnings from the government employment office, in the event of their employer's insolvency.

According to Section 113 of the Insolvency Act, the insolvency administrator may discharge an employee upon giving a 3 month notice of termination. This is true even if the contractual or normal termination notice period provided by law is longer. This has practical significance primarily in the case of employees who have worked for the insolvent business for a long time, because such employees are often entitled to a much longer notice of termination. Termination of employees under the Insolvency Act are subject to challenge before the Labor Court just like any other termination. The termination can be challenged on the basis that it is not justified in light of the fact that the business is to be continued in operation. As a rule such a complaint has a chance of success only if the debtor employs more than ten persons. Only then are the provisions of the "Kündigungsschutzgesetz" (Termination Protection Act) applicable. (Note: See chapter "Aspects of German Labor Law").

Despite the applicability of the Termination Protection Act, the insolvency administrator can reduce the number of employees in order to reorganize the business, provided that he is able to convince the Labor Court that the termination of a certain number of employment contracts is absolutely necessary and that such terminations are fair. This latter condition can be shown to have been met by evidence that the insolvency administrator has taken the employees' length of service, age and support obligations into consideration in determining which employees to terminate.

5 The Insolvency Plan

A special variant on the outcome of the insolvency proceedings is the establishment of an insolvency plan. This plan, which can be presented by the debtor or by the insolvency administrator, enables the insolvency proceedings to be handled in more flexible ways. The parties can resolve a procedure which differs fundamentally from the insolvency proceedings described under Sects. 2–4 of this chapter.

While the usual outcome of insolvency proceedings is liquidation of the business, the adoption of an insolvency plan can result in the business being transferred to a third party or the business being continued in operation or continued in operation in a reorganized form rather than being liquidated.

An insolvency plan must be presented in a writing and contain a description of the stage reached in the insolvency proceedings, the measures which remain to be taken, the treatment of the creditors, etc.

The court can reject the insolvency plan under certain conditions, for example, if the debtor has presented a plan, which is obviously not feasible. If the court does not reject the plan, then it is presented to the creditors for their approval. For this purpose, the creditors with the most similar financial interests are grouped together. The insolvency plan is then deemed accepted by the creditors if the following two conditions are met: (1) a majority of all creditors in each group agree to the plan and (2) the creditors in each group who have approved the plan represent a majority of the claims in such group (according to amount).

It is further deemed to be accepted if the majorities have not been reached, even though the plan was reasonable for the group rejecting the plan (prohibition of obstruction).

If the plan is accepted, then its content determines whether claims shall be forgiven or deferred, or whether property of the debtor shall be sold etc. In other words, the insolvency plan determines how the insolvency proceedings shall be carried out.

6 Discharge of Remaining Debt

In Germany the usual limitation period for the claims (i.e., period after which existing claims are barred) is 3 years, unless an executory title for the claim is existing. *In such case the limitation period is 30 years.* However, a debtor has the possibility of achieving a discharge of his liabilities if he undergoes a certain procedure and thereafter can show that in the 6 years following the beginning of the insolvency proceedings, he tried his best to fulfill his obligations vis-à-vis his creditors.

As implied in the above sentence, a debtor is entitled to such a discharge only if he has been the subject of a bankruptcy proceeding which has been finalized. Upon the debtor's application for discharge, the court releases the debtor from his remaining liabilities on the condition that he complies with certain duties, including:

- That he be reasonably gainfully employed or at least has made a good faith effort to secure gainful employment
- That to the extent not urgently required for his support or the support of his family, he makes half of all assets which he acquires through inheritance, the lottery, or earnings available to his creditors
- That he provides notice of all changes of his address

7 International Insolvency Procedures

It is now common practice that foreign companies keep up branch offices in Germany and that German companies keep up branch offices abroad. If such company becomes insolvent, the question of which law is applicable to property abroad.

Germany, like the entire European Union, has decided to recognize insolvency proceedings instituted abroad if – according to German law – the foreign court is competent for the proceedings. Regarded as competent for the proceedings according to German law is the court where the debtor’s centre of business activities is located.

On the other hand, German courts apply German law in insolvency proceedings in Germany to the debtor’s assets situated abroad.

However, there are a number of exceptions to the above principles.

It is possible to open separate insolvency proceedings against the German company’s property abroad or against a foreign company’s property situated in Germany. In such a case, the law of the country in which the separate proceedings are filed is applicable.

Moreover, German law applies in cases regarding security interests on property created under German law. The creditor to whom a security interest was created according to German law, may trust that his position will not be less favourable than it would be the case at German insolvency proceedings (Section 351 German Insolvency Law). Furthermore, according to the aforementioned rule, German law generally applies to immovable property. In this regard, the foreign insolvency administrator does not have more options than those provided by German law.

Unfair Competition

H. Schroeder

1 Introduction

It is generally recognized that in a social market economy, free competition among the market players has to be regulated to a certain extent. The law on competition (*Wettbewerbsrecht*) has the task of providing such regulation to the business activities of all the players in a fair and reasonable manner. In Germany, the greater and most essential part of the legislation concerning competition is systematically contained in the Unfair Competition Act [*Gesetz gegen den unlauteren Wettbewerb* (UWG)], which was thoroughly reformed in 2004. Competitive regulations can furthermore be found in other laws, for instance, in the Trademark Act [*Markengesetz* (MarkenG)], in the Law against Competitive Restrictions [*Gesetz gegen Wettbewerbsbeschränkungen* (GWB)], in the German Civil Code [*Bürgerliches Gesetzbuch* (BGB)], in the Law against Advertising in the Health-Care Sector (*Gesetz gegen Werbung auf dem Gebiet des Heilwesens*), in the Food and Feeding Stuff Act [*Lebensmittel- und Futtermittelgesetz* (LFGB)] and in the Price Indication Regulation [*Preisangabenverordnung* (PAngV)].

The body of laws of the European Community also contain partial regulation of legal matters involving competition. Both primary laws (EC agreements) and secondary laws (ordinances, directives, decisions) contain regulations that impact domestic law in the member states. They are directly applicable in Germany (as well as in all of the other member states) and take precedence over any national law that might stand in conflict with them. Some of the most significant provisions of primary Community law are contained in the objective of Article 3 lit. g) EG (system of unadulterated competition), the prohibition of discrimination (Art. 10 EG), the regulations for the protection of the free movement of goods (Art. 28 ff. EG) as well as the free marketing of services (Art. 49 ff. EG). Examples of the regulations of the secondary order of Community law include EG Regulation VO 2409/92 (airfares) and the directive on misleading and comparative advertising (84/450/EWG and 97/55 EG). There are also other laws of international relevance deserving of attention, such as, for instance, the Paris Convention [*Pariser Verbandsübereinkunft* (PVÜ)] and bilateral treaties for protection against unfair competition.

This chapter will be restricted to a portrayal of the essential content of the German Unfair Competition Act [*Gesetz gegen den unlauteren Wettbewerb* (UWG)] and the actual assertion of claims on the basis on it.

2 Protective Objective and Field of Application

As Section 1 UWG asserts, the purpose of the law is to ensure the “protection of competitors, consumers and other market participants against unfair competition. At the same time it protects the public interest in unadulterated competition.” Hence, the objects of protection of the law on unfair competition are not only the businesses competing with each other but also, and of equal standing, consumers in general, all other parties engaged in market activity and the public body in terms of its inherent interest in unadulterated competition. However, the law regulating competition does not protect any other public interests such as its interest in employee or environmental protection.

Generally speaking, entrance is made into the field in which the UWG applies whenever a so-called “competitive act” (*Wettbewerbshandlung*) is undertaken. That term is one of the central concepts of the UWG. In Section 2, sentence 1, no. 1 UWG a “competitive act” is defined as any act of a person aimed at the promotion of the sales or the acquisition of goods or the promotion of the performance or receipt of services, including immobile objects, rights and obligations, either to the benefit of his or her own enterprise or to that of another party.

3 General Clause and Exemplary Violations

The most important clause in the UWG is the general clause contained in Section 3, which postulates the general prohibition of unfair trade. It forbids unfair competitive acts that are capable of impairing competition to the detriment of the remaining competitors, consumers or other participants in market activity in a more than insignificant way. This regulation is to be viewed within the context of the protective objective defined in Section 1 UWG. It is substantiated in Sections 4–7 UWG through the listing of numerous, though not exhaustive, examples of violations. Only when a competitive act cannot be subsumed under Sections 4ff. UWG, can it be evaluated on the basis of the general clause. However, in that event it must be examined whether or not the case examples listed in Sections 4ff., which are not clearly pertinent to the matter at hand, have a conclusive intent in which case recourse to the general clause in Section 3 would be ruled out. The provision expressed by Section 3 UWG does not require any subjective elements of unfairness, since the detrimental effects of an unfair competitive act exist independent of any subjective notions on the part of the perpetrator. However, what is essentially important, the unfair competitive act is capable of causing an impairment of competition that is “more than

insignificant.” The wording here indicates that the intent of the lawmakers was to exclude the prosecution of so-called petty offenses. We are no longer dealing with a petty offense, however, when the unfair act suffices to disadvantage other competitors, the consumers or any other participant in market activities, or, in other words, impairs their interests as market participants.

The section below will present an overview of the most significant types of violations (Sections 4–7 UWG) and cases in which the UWG is applied:

3.1 Inappropriate Nonfactual Influencing (Section 4 No. 1 UWG)

Section 4 no. 1 UWG includes a further general clause, which strives to protect the free choice of consumers and other market participants against nonfactual influencing. It defines any and all competitive acts as unfair that are capable of impairing the free choice of consumers or other market participants by applying pressure on them in a way showing human disrespect or by influencing them in any other inappropriate and unobjective way. Of decisive importance here in terms of the general clause is whether or not the competitive act is capable of disabling the rationality behind a purchasing decision made by an average consumer of normal intelligence with an average amount of information and an adequate degree of awareness (in relation to the situation at hand).

Section 4 no. 1 UWG covers, by way of example here, the case categories of taking enticement too far, applying mental compulsion to buy, emotional advertising and promotional activities (discount advertising). Promotional activities are to be understood as all monetary benefits that are granted as means of promoting the sales of goods or services. According to a ruling by the German Federal Supreme Court [*Bundesgerichtshof* (BGH)], promotional activities are to be considered permissible insofar as they do not present such a strong attraction that consumers are detained from even considering the price merit and quality of the offer in relation to the competitive products that are on the market. Previously, the permissibility of promotional activities was judged very severely by the courts but now, the courts pursuant to the recent legal reforms in this area, only have the function of performing a certain “kind of abuse control.”

3.2 Camouflaged Advertising (Section 4 No. 3 UWG)

Section 4 no. 3 UWG specifies that a party is acting unfairly whenever it conceals the competitive nature of its competitive acts. A violation exists when a sales promoter establishes contact with consumers (or other market participants) behind a veil of noncommercial activity only to then turn around and confront them with a sales pitch motivating them to place orders. Such activity might include camouflaged sales events (in Germany these frequently take the form of

cheap “sightseeing” 1-day bus or boat trips, whose ulterior motive is to cart people to some sales event), the disguising of advertising as scientific and/or objective announcements and product placement. The German Supreme Court has determined that product placements in films shown in movie theaters open to the general public are not permissible if and when the company whose product and/or corporate logo or identity is conspicuously being displayed in the film in any way has paid a rather significant amount of money to have it done.

3.3 Information Obligations of Sales Promotions/Contests and Drawings

(Section 4 no. 4–6 UWG)

Section 4 nos. 4 and 5 UWG contain precepts for ensuring transparency and hold sales promoters responsible for making the conditions of participation in any contests or drawings sponsored by them or the acceptance of anything won in them completely clear to the potential participants beforehand. Measuring any particular case against this standard would require looking into and determining how much information would have been required at each stage of the matter from the perspective of a reasonably intelligent consumer.

Section 4 no. 6 UWG prohibits combining contests and drawings with the selling of goods and/or services. The only exception is the selling of the article or service that “by its very nature” is the vehicle of communication of the contest or drawing, such as, for instance, the newspaper or magazine that offers a reward for solving a puzzle of some kind contained in its editorial section.

3.4 Hindrance of Competition (Section 4 No. 10 UWG)

The regulation forbidding the hindrance of competition is there to protect all competitors and is intended to prevent impairment of the other competitors’ possibilities for growth and development. It is forbidden to interfere with their growth and development in any way or in any area, not only in sales but also in such areas as procurement, advertising, production, research, development, planning, financing, the use of human resources, and so on. A violation of Section 4 no. 10 UWG exists only when companies make a deliberate and targeted effort to impede the full market participation of a competitor, such as by way of a boycott, cut-throat competition or the abuse of the power of demand. For example, it is also unfair to make a focused attempt to buy out any goods put on sale by a competitor in order to deplete his stock or restrict his capacity to supply, thereby creating the impression that his sales campaign was a hoax.

3.5 *Legal Offenses (Section 4 No. 11 UWG)*

According to Section 4 no. 11, anyone who breaks a law that is there to regulate market behavior in the interest of all the market participants is acting unfairly. This violation is of enormous practical relevance. However, it is important to note that insignificant legal offenses are considered petty cases and not worthy of prosecution. The only offenses that are covered by this provision are those that have a reference to the market economy and thus also impact market behavior. Such would include violations of the Price Indication Regulation (*Preisangabenverordnung*) or the Store Closing Hours Act (*Ladenschlußgesetz*) as well as offenses against the numerous legally regulated advertising restrictions and obligations to provide information for consumer protection. A violation occurs even if the perpetrator acts without awareness of the fact that he is committing an offense.

3.6 *Misleading Advertising (Section 5 UWG)*

Section 5 UWG specifies that anyone who advertises in a misleading way is committing an unfair act in terms of Section 3 UWG. Section 5, sentence 2 UWG contains a list of examples of misleading advertising that is divided into the categories of the products being offered (no. 1), the circumstances and conditions of the offer (no. 2) and the company doing the advertising (no. 3). Section 5, sentence 2 UWG specifies that even nondisclosure of a fact can constitute misleading advertising. Section 5, sentence 4 UWG contains the legal assumption that a case of misleading advertising exists whenever the price of an item is reduced only for an unreasonably short amount of time. Furthermore, this paragraph states that it is misleading to advertise a product without having enough of it in stock to meet the demand being generated. It notes that as a general rule the supply is to be considered adequate if there is enough of it to last for 2 days.

3.7 *Comparative Advertising (Section 6 UWG)*

Comparative advertising has only been allowed in Germany since 1997. According to Section 6, sentence 1 UWG comparative advertising is any kind of advertising that directly or indirectly draws attention to goods or services being offered by a competitor. Section 6, sentence 2 UWG and other provisions define such advertising as unfair in terms of Section 3 UWG whenever it refers to products or services that are not aimed at filling the same need or that do not have the same fundamental objective, whenever no objective reference is made to one or more essential, relevant, testable and typical qualities or to the price of the competitive item or whenever

the advertising could cause consumers to get certain products and services mixed up, mistaking one for the other.

3.8 Intolerable Nuisance (Section 7 UWG)

Section 7, sentence 1 UWG contains a general clause stating that an unfair act as per Section 3 UWG exists whenever someone's promotional activities present a market participant with an intolerable nuisance. The question of what exactly constitutes an intolerable nuisance is dealt with in Section 7, sentence 2 UWG. Such a nuisance is seen as existing, for instance, whenever advertising (and marketing) occurs against the recipient's obvious will. A distinction has to be made in the area of telephone marketing which constitutes an intolerable nuisance for consumers if it is done without their consent and for other market participants if it is done without at least the assumption of consent. Marketing that occurs by way of automatic dialers with recorded messages, fax machines or e-mail is permissible in the case of both consumers and business operations, only if and when the recipient has given his consent.

4 Assertion of Claims Arising from Violations of the Laws Against Unfair Competition

Claims arising from actual violations of the laws against unfair competition are treated by way of conclusion in the Sections 8–10, of the UWG. The most important and most relevant of these is the right to cease and desist. Other rights include the rights to removal, damage compensation and profit skimming.

Who is entitled to the assertion of such rights depends on the particular nature of the violation. In the case of rights to cease and desist and/or to removal, as a general rule the parties entitled to their assertion would be any competitors who have a "concrete competitive relationship" to the perpetrator. The claims can also be asserted by legally registered associations for the furtherance of commercial or professional interests (e.g. business associations) and consumer protection agencies as well as chambers of commerce and trade associations (Section 8, sentence 3 UWG). However, only those competitors who are actually involved in a "concrete competitive relationship" have the right to assert claims to damage compensation (Section 9 UWG). On the other hand, the profit skimming right defined in Section 10 UWG can be asserted by the associations listed above to compensate for "scattered damages" and cannot be enforced by competitors.

The defendants in suits involving the assertion of such claims are anyone who has personally violated the laws prohibiting unfair competition, whether they have done so as the actual perpetrator or as an accomplice, as instigator or by aiding and abetting the offense. In the assertion of claims to cease and desist and/or to removal of the

offense, any offenses committed by the employees or contractors of a business owner are ascribed to him personally (Section 8, sentence 2 UWG). Other breaches of civil regulations could be ascribed to him as well (Sections 31, 278 and 831 BGB).

The object of a claim to cease and desist is the removal of existing interferences and the prevention of any future ones. No proof of fault is necessary. The general requirement is the existence of a danger of commission (*Begehungsgefahr*); such is normally assumed to be the case whenever there is a danger of repetition of an offense that has already been committed once (*Wiederholungsgefahr*). If there has been no previous offense yet the commission of one is apparently in the making, there exists a danger of first-time commission (*Erstbegehungsgefahr*), which can suffice to substantiate a petition for an (preventative) order to cease and desist. The right to demand removal of the offense is, like the right to petition for an order to cease and desist, a defensive right. It enables the parties whose rights have been impinged upon to demand permanent removal of the conditions causing the interference. It is important to note that, as opposed to the assertion of the above defensive rights, the right to claim damages requires unlawful conduct on the part of the perpetrator.

The statutes of limitations for claims arising from the violation of the laws on competition differ from case to case. However, as a general rule, it can be said that the rights to petition for an order to cease and desist or for removal and the right to claim damages expire 6 months after the right came into being and the owner of the right gained knowledge of its existence (Section 11 UWG).

In the majority of cases (about 90%), claims arising from the violation of the laws on competition are settled out of court. The claimant sends the defendant a warning and he in turn promises to put a stop to the unfair activity and to pay a certain amount of money by way of penalty in the event that he breaches that promise. The issuance of such a warning is not a required preliminary step before filing a court complaint, but it is always recommendable to give the defendant notice before taking the matter to court, setting a deadline for him to issue his formal promise to cease and desist. Upon receipt of the formal promise containing mention of the exact amount of the penalty for breach of promise, the claimant is in possession of a solid contract-based claim, and in the event of repetition of the offense can sue the defendant for payment of the penalty. Provided the warning is justified, the claimant can also demand reimbursement of his expenses for issuing it, particularly the reimbursement of attorney fees (Section 12, sentence 1 UWG).

Claims arising from the violation of the laws on competition asserted in court generally take the form of petitioning for the issuance of a prohibitory injunction, as there is usually a need for fast regulation and the imposition of sanctions. Section 12, sentence 2 UWG explains that in the case of petitions for prohibitory injunctions, the need for urgent action is to be generally assumed. The defendant has the right to file an objection against the court order to impose an injunction. If, on the other hand, he does not wish to defend himself against the injunction, he must send a so-called “closing letter” (*Abschlusschreiben*) to the court, indicating that he recognizes and accepts the regulation imposed by the injunction as final and binding. Failure to do so would result in a cost-intensive hearing.

5 Criminal Offenses Through Breaches of the Laws on Competition

Although the UWG focuses on civil-law sanctions, criminal offenses are dealt with in Sections 16–19. Punishable as criminal offenses are any advertising that deliberately misleads by making untrue statements (Section 16, sentence 1 UWG), the deliberate creation of so-called “snowball effects” (Section 16, sentence 2 UWG), the deliberate betrayal of business and operational secrets (Section 17 UWG), the deliberate commercial exploitation of technical documents (Section 18 UWG) as well as the deliberate instigation and enticement to betrayal (Section 19 UWG).

The Law of Public Procurement

N. Müller

1 Introduction

The law of public procurement (*Vergaberecht*) regulates the terms and conditions under which public authorities award orders, that is to say, under which they are allowed to enter into remunerated contracts for goods and services.

The law of public procurement currently in force in Germany is characterized by a dualism between traditional German budgetary law and the laws of the European Union, which is in the process of assimilating.

Understanding the system is complicated by the fact that the regulations of the European Union have not completely replaced the old national regulations, but have merely supplemented or modified certain sections of them. Hence, EU directives that have been adapted by national law are only applicable when certain budgetary thresholds have been exceeded in potential order volumes, and even then there are several exceptional cases in which the traditional German law of public procurement is applicable after all.

2 The Legal System of Public Procurement

2.1 *Traditional German Public Procurement*

2.1.1 Budgetary Approach

Traditionally, the German law of public procurement was a part of the law of public budgets (budgetary law). The law of public procurement was devised to provide a regulated administrative process for the issuing of orders in an attempt to avoid wasting budgetary resources. It was dominated by the principles that prevailed in budgetary law: those of austerity, economy and secured procurement. Austerity and economy were served by searching for the cheapest and best offer among the bidders and thereby, fueling competition among them.

2.2.2 Applicable Regulations

The legal principles of public procurement are contained according to their ranking in the Budgetary Principles Act (*Haushaltsgrundsätze-gesetz*, Section 30 HGrG) and in Section 55 of both the Federal Budgetary Regulations (*Bundshaushaltsordnung*, BHO) and the State Budgetary Regulations (*Landeshaushaltsordnung*, LHO). Local authorities added their own stamp to those guiding principles in creating their budgetary regulations. Questions concerning the details of public procurement can be answered by resorting to special sections of the so-called standard official contracting terms (*Verdingungsordnungen*). There are currently two sets of standard official contracting terms for procurements based on budgetary law:

- Standard building contract terms (*Vertrags- und Vergabeordnung für Bauleistungen*, VOB)
- Standard contracting terms (*Verdingungsordnung für Leistung*, VOL)

As the name indicates, the standard building contract terms (VOB) contain regulations for contracting services in the building sector. On the other hand, the standard contracting terms (VOL), regulate all other types of contracts.

Section A of the VOB and the VOL contain the terms of procurement (VOB/A, VOL/A), whereas their B sections contain contractual regulations (VOB/B, VOL/B) that come into play when placing the order with the best bidder. Furthermore, the VOB contains a section C, which is comprised of technical regulations pertaining to the manner in which each of the performance tasks of the project is to be carried out. In addition, section C contains regulations concerning the manner in which the work has to be assessed and invoiced.

However, only the A sections of the VOB and VOL will be dealt with here, as only they are directly concerned with the law of public procurement.

The above-mentioned regulations are currently only applied in their standardized form in public procurement processes when the project budget is below a certain limit, that is, whenever the standard EU terms of public procurement are not applicable.

2.2 Standard EU Terms of Public Procurement

2.2.1 EU Directives on Public Procurement

Today the German public procurement laws that are applicable to the majority of public orders are characterized to a very large extent by the assimilation of the following EU directives by national law:

- Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts
- Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors

- Directive 89/665/EEC on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts, and
- Directive 92/13/EEC coordinating the laws, regulations and administrative provisions relating to the application of Community rules on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors

2.2.2 Functional Definition of the Public Authority

Whereas the classical German law of public procurement presents a formal definition of a public authority, EU law views the public authority in a functional way. From the latter point of view, the legal form assumed by the public authority is of no importance. It is only the function the public authority is fulfilling at the time that is taken into consideration. Hence, pertinent to Section 98 of the Act Prohibiting Restrictions of Competition (GWB) public authorities include, among others:

1. Territorial bodies (e.g. federation, states, etc.) as well as their separate properties
2. Other legal entities under public or private law which were created in order to fulfill non-profit tasks in the public interest and which are financed, essentially controlled or supervised by public offices
3. Associations whose members are categorized under either (1) or (2) above
4. Companies in the field of drinking water or energy supply or in the transportation or telecommunication sector, whenever they operate on the basis of exclusive or extraordinary governmental rights or are controlled by public authorities who fall into one of the categories from (1) to (3)
5. Companies whose construction work as defined by law is financed to more than 50% by public authorities who fall into one of the categories from (1) to (3).
6. Item 5 is also applicable when the companies mentioned are not compensated for their work in cash, but rather with the right to use the building facilities

2.2.3 Basic Principles of the EU Law of Public Procurement

The budgetary approach of the traditional German law of public procurement has essentially been superseded by the above directives. The prevailing principles of the European approach, in addition to economy, are competition, transparency and non-discrimination.

Competition and Economy

These principles are not to be considered as existing separate from one another, but rather as existing in close interdependency. That is to say, the EU competition principle derives from the notion that competition among several bidders leads to

real market prices and conditions, which in turn in the majority of cases guarantees the public authorities that they are conforming with the principle of economic budgeting.

Transparency

The principle of transparency also serves the above purpose. Transparent processes are meant to ensure that all procurements by public authorities can be reviewed in order to make sure that they conform with the regulations prohibiting discrimination. This principle goes hand in hand with the principle of competition, as only processes that are transparent can enable true competition and make distortions so apparent as to virtually prevent them. The transparency principle gives way to regulations such as those governing the publication of a tender notice and the public notification of the results.

Non-Discrimination

The principle of non-discrimination is also tightly interwoven with the principle of competition. It calls for equality in the treatment of all of the bidders – and this independent of whether or not they are domestic bidders or bidders from other Member States of the European Union. The latter are to have the same rights as domestic companies to offer, and ultimately to provide their services. All of the bidders are to be treated equally throughout all of the phases of the procurement process, thereby ensuring equal chances for all of them.

Special Support for Small and Mid-Sized Independent Businesses

The German assimilation of European law presents a certain exception to the principle of equal treatment in the procurement process by its application of the principle of special support for small and mid-sized independent businesses, which consists of breaking down large orders into various “specific and partial lots”. That offers bidders a chance to compete who would otherwise not be able to do so, not being in a position to cover the whole range of services necessary to fulfill the order and/or not having the financial backing to do so. This special support principle allows them to compete for orders for services limited to the special kind they provide (*Fachlose*) and for only a share of the entire project (*Teillöse*).

The explicit special support for the small and mid-sized independent businesses is a particular German version of the assimilation of EU law into national law, as EU law itself does not directly provide for such. With the institution of this principle, the German legislature gave due recognition to the large contribution small and mid-sized companies make to the overall economy of Germany.

2.2.4 Applicable Regulations

The central regulation for EU public procurement law that has been assimilated by German law is Part IV of the Act Prohibiting Restrictions of Competition. The Public Procurement Regulation (Vergabeordnung, VgV) was enacted on the basis of it. It calls for the application of the standard official contracting terms already mentioned above (VOB and VOL) for regulating contractual details, terms which had previously been applicable only in conjunction with the requirements of budgetary law. Furthermore, it determines that certain procurements have to be made on the basis of yet another set of standard official contracting terms, namely the standard official contracting terms for professional services carried out by “liberal professions” (Verdingungsverordnung für freiberufliche Leistungen, VOF).

The VOF regulates the contracting of professional services (*höhere Dienstleistungen*) from members of the “liberal professions” (*“freie Berufe”*). What all of the members of the so-called “liberal professions” have in common are their academic or highly specialized education and qualifications and/or their creative talent, which enables them to render the highest level of professional service in person, on their own account and independently, e.g. consulting services. Members of the liberal professions include, for example, lawyers, architects and journalists. However, the VOF is applicable only when the service to be contracted cannot be precisely defined in advance in terms of its scope and duration, which is the case, for example, in need analyses. In all other cases the VOL is applicable, provided they are not concerned with building contracts.

The VOB and VOL for contracts exceeding certain proscribed price thresholds have been supplemented by so-called “a” and “b” paragraphs. The VOL, for example, assumed the following structure:

- First section: Basic paragraphs, procurements under budgetary law
- Second section: “a” paragraphs, procurements under EU law
- Third section: “b” paragraphs, procurements under EU law for certain sectors

The regulations contained in the “a” paragraphs are based on Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts.

The regulations contained in the “b” paragraphs are based on Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors. The purpose of this is to make sure that contractors whose services involve the fulfillment of certain basic utility needs of the general public and who are permitted to render those services on the basis of certain exclusive privileges do indeed work efficiently, and do not disadvantage consumers by demanding prices that are too high or use their strong market position to pressurize and exploit their suppliers.

2.2.5 Threshold Amounts

The determination of whether or not the above-mentioned EU directives are applicable in the first place or whether the traditional German law of public procurement is to be applied is regulated by Section 100 of the Act Against Restraint of Competition (GWB), in conjunction with Section 2 of the Public Procurement Regulation (VgV). The first step in the procedure is the determination of whether the planned order exceeds certain threshold amounts. These amounts will be updated by the EU-Commission every two years. From January 1, 2008, the following amounts shall be valid:

- € 5,150,000 for building contracts
- € 412,000 for service contracts and purchase orders in the potable water, energy and transportation sectors
- € 133,000 for service contracts and purchase orders issued by the highest ranking departments of the federal government with the exception of certain orders issued in the defense sector
- € 206,000 for all other service contracts and purchase orders

There are also special regulations that come into play whenever service or building contracts are broken down into various lots. In the case of service contracts that exceed a total volume of more than € 206,000, any single lots in excess of € 80,000 are subject to the regulations of the “a” or “b” paragraphs, depending on the sector in question. If they are below that threshold, this regulation applies only if the composite sum of the remaining lots does not exceed 80% of the overall value of all of the lots. In the cases of construction work with a composite monetary value of more than € 5,150,000, any single lots in excess of € 1,000,000 are subject to the “a” or “b” paragraphs, as the case may be. When they fall short of that threshold, the regulation applies only if the composite sum of the remaining lots does not exceed 80% of the overall value of all of the lots.

2.2.6 Exceptions to the Application of the Above Regulations (GWB and VgV) Despite Surpassing of the Threshold Amounts

As already mentioned, whenever the threshold amounts listed above are surpassed, the Act Against Restraint of Competition (GWB), the Public Procurement Regulation (VgV) and the applicable set of the official standard contracting terms together with their “a” and “b” paragraphs come into play. Section 100 of the GWB also contains a catalogue of exceptional cases, to which regular budgetary law and the basic paragraphs of the VOL and VOB apply, even though the threshold amounts have been surpassed. The exceptional cases are of various nature. The following itemization presents typical examples:

- Section 100 d GWB: Orders that are declared secret under German law or whose manifestation requires special security measures or whenever the protection of essential security interests of the state demand such secrecy

- Section 100h GWB: Orders for the procurement of, for the rental of or for the acquisition of rights to land, existing buildings or other immobile assets regardless of how such is financed
- Section 100n GWB: Orders for research and development services, unless the results of such work shall become the sole property of the purchaser for his use in the performance of his duties and the work shall be entirely remunerated by the purchaser

3 Public Procurement Procedures

3.1 The Most Important Types of Procedures

Both German and EU public procurement law foresee essentially four different ways to place orders for contracted construction work and services and for purchase orders – the open procedure, the restricted procedure, the negotiated procedure and, since 2005, the competitive dialogue. Somewhat different terminology is used in the case of procurement under the threshold values, which are carried out in accordance with the basic paragraphs of the VOB and VOL, but the three traditional procedures are nonetheless virtually identical. The open procedure is equal to the public call for bids, the restricted procedure is the equivalent of the restricted call for bids and the negotiated procedure is the same as single tender action.

As a general rule, the public authority is committed to selecting the open procedure, unless special reasons permit the use of the non-open, the negotiated procedure or even the competitive dialogue. Here, German public procurement law deviates somewhat from the EU directive, according to which only the choice of the negotiated procedure or the competitive dialogue requires a special reason and leaves the choice between the open and restricted procedures up to the decision of the public authority.

As opposed to services pursuant to VOB and VOL, services pursuant to VOF are always contracted by way of the negotiated procedure. Calls for participation in the competition are publicized at regular intervals in advance – a way of proceeding that can be dispensed with only in exceptional cases.

3.2 Open Procedure

In an open procedure, any company interested in participating has the opportunity to submit a proposal. The proposal must conform with the requirements of the administrative department that issued the call. No alterations of the standard application documents, e.g. of the legal terms and conditions contained in them are permissible, as that would make it very difficult if not impossible to compare the offers. The terms of contract are thus laid out exclusively by the office calling for the bids. Any violation of this principle by a bidder automatically disqualifies him and his submission is rejected.

In parity with these restrictions, the public call for bids must also mention all of the things that are necessary for a bidder to submit a proper and complete proposal. This often presents a major challenge to the public authorities, particularly when they are dealing with highly technical subject matter. In such cases, the bidders are allowed to ask questions during the submission phase of the process in order to clarify the content of the call for proposals. The answers to these questions are shared with all of the bidders so as to conform with the principles of non-discrimination and transparency.

The forbiddance of any modification of the terms and conditions of the call for bids is particularly worthy of notice with respect to the general terms of business and standard contract forms that are preferentially used by U.S. companies. Such standardized forms cannot be successfully submitted in an open procedure in Germany.

In the event that a bidder cannot or does not want to fulfill all the requirements of a call for proposals, the most he can do is submit a so-called “auxiliary bid” (*Nebenangebot*). Whether or not auxiliary bids are even permissible or whether or not they are only permissible in the context of a main tender can be derived from the public announcement of the call for bids.

Outside of the submission of a auxiliary bid, the only possible way to influence the terms and conditions of the offer is to file an official administrative complaint and initiate review proceedings (see Sect. 4.2). However, this is only possible when there has been some violation of public procurement law, and allegations to that effect seldom hold up under close legal scrutiny. On the other hand, a violation of public law can indeed exist if the announcement of the call for bids made it impossible to submit a clear offer because it failed to make certain essential statements or because it contained contradictory statements.

It is also important to note that in an open procedure, the bidder who receives the contract is the one who has submitted the most economical offer. With the announcement of the winner, the order is automatically placed and a legally binding contract for the services as described comes into being. This also means that no further negotiation of the conditions of contract are permissible after the fact.

It is also not permissible to modify any proposals once the submission deadline has been surpassed, which thwarts any late and unfair attempts to underbid the other competitors.

3.3 *Restricted Procedure*

In a restricted procedure, only certain companies are requested to submit a proposal. They are companies that have been selected in a preliminary participation contest, the request for participation in contracts. On the other hand, the request for participation is open to all companies and any of them can submit proposals for participation. In the request for participation, they are required to make statements

in regard to their special know-how, performance capability and reliability that can be used to judge their eligibility for the second round. The required submission materials can include such things as certificates and references or even clearance certificates issued by the local branch of the Federal Tax Office (*Unbedenklichkeitsbescheinigungen des zuständigen Finanzamts*) and similar documents.

In the case of procurements under the threshold amounts, the law does not absolutely require that an open request for participation be held preliminary to a restricted call for bids. If the administrative office issuing the call has sufficient knowledge of the market, it can do away with the request for participation.

In this procedure as well, just as was the case in the open procedure, an application for a contract has to be submitted precisely the way indicated by the administrative office issuing the call, which is to say that there can be no modifications of the standardized submission forms and the bidders are not allowed to attach their own general terms of business of standard contracts. Subsequent corrections or negotiations of the proposals are likewise impermissible.

3.4 Negotiated Procedure

The Act Against Restraint of Competition views this procedure as an exception that comes into play only when the important reasons mentioned by the standard official terms of contract permit it. For example, this is the case when no economic results can be expected from an open or a non-open procedure, when such a procedure has already been conducted without producing any economically feasible results, when there is only one particular company that is capable of providing the required service, or when there is time pressure due to the occurrence of unforeseen events and it is no longer possible to carry out any other procedure. Depending on the reason for initiation of the negotiated procedure, a preliminary participation contest may or may not be required.

3.5 Competitive Dialogue

This new procedure shall be used for very complex projects only, where the public authority is not able to give a detailed specification for the requested performances.

Therefore, the public authority has to select a number of companies which shall create such a specification in dialogue with the public authority and each other. Afterwards the public authority chooses again some or all of these companies for a kind of a restricted procedure, where the corresponding companies each may submit a detailed tender according to the developed specification.

3.5 Typical Pattern of an Open Procedure

The procedural patterns that are followed in open procedures are extremely complicated and varied due to the fact that they are subject to different rules and regulations (VOB and VOL, application of the GWB and VgV and the “a” or “b” paragraphs of the VOL or, as the case may be, the VOB or VOF in procedures that exceed their threshold amounts), there are various different types of procurements and in some instances exceptional rules can apply. Therefore, it is not feasible to comprehensively describe all of the possible procedural patterns in the present context. For that reason, the basic pattern that is followed by a procurement procedure will be described here using the example of a normal open procedure.

3.5.1 Preliminary Information and Public Announcement

The central publication medium for preliminary information pertaining to procurements with a value ranging above the threshold amount is the Official Journal of the European Union (*Amtsblatt der Europäischen Union*). A preliminary notification of the pending procurement procedure is published there and has the intention of giving potential bidders the opportunity to roughly plan the distribution of their resources. It is followed by the actual announcement, which contains information pertaining to the way in which interested bidders can obtain the official application documents. It also contains all the information necessary for bidders to submit complete tenders as well as a statement of the procedural details, such as the deadline for submitting tenders and the date of closing.

3.5.2 Submission of Tenders

The official standard contracting terms (VOB, VOL and VOF) contain extensive rules and regulations that any submitted tender has to conform with in order to be accepted for consideration. Merely by way of example, the tender has to be signed with a legal binding signature, all of the statements contained in a tender have to be unambiguous and transparent, no changes can be made to the standard application forms, the tender must be submitted in a sealed envelope contained inside the envelope in which it is sent, etc.

3.5.3 Formal Steps in the Evaluation of Submitted Tenders

Once the submission deadline has been surpassed, all of the tenders received are evaluated and successively weeded out according to the following criteria:

Automatic Disqualification

The first tenders to be weeded out are those that do not comply with the obligatory rules and regulations (e.g. missing signature).

Discretionary Disqualification

Not all rules and regulations absolutely require compliance and automatically disqualify any tenders that do not comply. In some cases, non-compliance *can* result in disqualification though not necessarily. The next step involves the evaluation of cases of such non-compliance and the decision of whether to disqualify them or not.

Rejection of Bidders Not Qualified for the Job

In the next round, the tenders are examined with the intention of determining whether or not the bidders create the impression of being qualified to properly render the services offered. That is done mainly by examining the attached documents and the statements made in regard to technical know-how, performance capability and capacity as well as reliability. This evaluation corresponds to the evaluation process that is followed in preliminary contests for participation. The tenders of any bidders which do not meet these criteria are added to the rejection pile.

3.5.4 Content Evaluation

Only the remaining tenders are evaluated in terms of their content. Here the service offered and the price that is asked for it are the most important evaluation criteria. The evaluation criteria have to have been uniformly selected. Some government offices offer assistance to public authorities in the determination of the uniform criteria to be used in evaluating tenders. The Federal Department of Interior, for example, issues a publication entitled “Document for the Call for Proposals and Evaluation of IT Services” (*Unterlage für die Ausschreibung und Bewertung von IT-Leistungen*, “UfAB”).

Insofar as certain items contained in the tender require further explanation, the administrative office issuing the call for bids can ask the bidders questions and communicate with them solely for the purpose of removing any doubts. It is, however, impermissible to make any modifications to the tenders during or as a result of such exchange. The most economical tender is then selected on the basis of the criteria previously selected.

3.5.5 Preliminary Notification of the Intent to Award the Contract

Once the selection of the bidder to whom the contract is to be awarded has been made, the other unsuccessful bidders are notified as to who the winner is (Section 13 VgV). Beginning with the date of that notification, the unsuccessful bidders have 2-weeks time to contest the decision and, as the case may be, initiate a formal review procedure. If the contract is awarded before the 2-week deadline has elapsed, the award is void. This regulation is intended to grant the bidders ample opportunity to initiate legal protection measures.

4 Remedial Rights

The possibilities of legal protection in public procurement procedures that exceed the threshold amount are essentially different from the ones that exist in procedures for procurements below the threshold, or, in other words, in procedures that pursuant to Section 100 Section 2 GWB do not fall under the regulations of the Act Against Restraint of Competition and the VgV.

4.1 Remedial Rights in Cases Where the GWB is Applicable, Particularly in Orders that Surpass the Threshold Amounts

Section 97 Section 7 GWB explicitly states that bidders have the right to insist on conformance with the official standard terms for public procurements.

4.1.1 Administrative Complaints in Regard to Public Procurements

The first step in filing administrative complaints in regard to public procurement is a preliminary procedure of sorts, and is defined by law as the issuing of a complaint to the public authority outlining the reasons for it as precisely as possible. The complaint must be issued immediately upon becoming aware of the violation of the procurement regulations. If a violation occurs in an announcement, for example, the complaint must be issued without delay immediately following the publication of the announcement. If that does not occur, the bidder loses his remedial rights in regard to that particular procedural violation. German courts are very strict in their interpretation of the words “without delay”. Obvious violations have to be challenged within just a few days. The absolute deadline for complicated complaints is 2 weeks. Many remedial rights proceedings end in failure due to this prerequisite. Especially in the submission phase, the bidders are concentrated more closely on writing good proposals than they are on the filing of complaints. A further barrier

that causes bidders to refrain from issuing complaints is the fear that they will suffer disadvantages in the selection process if they have done anything to make themselves unpopular with the public purchasers.

4.1.2 Review Procedure

Provided that the bidder has issued a complaint challenging the behavior of a public authority without delay and the public authority has failed to correct his behavior, the bidder has the right to initiate a formal review procedure. Procedures of this nature are presided over by federal or state procurement chambers. The federal chamber of public procurement resides in the Federal Cartel Office; the procurement chambers of the states can frequently be found in the office of the president of the state administration (*Regierungspräsident*) or in the superior finance directorate (*Oberfinanzdirektion*).

There is no specific deadline for the initiation of review proceedings, except for the fact that no petition can be filed after the contract has been awarded. Pursuant to Section 114 Section 1 GWB, no contract that has been officially awarded can be rescinded.

Once a petition for a review procedure has been received by the chamber of public Procurement and forwarded to the public authority, the latter normally has to wait until the chamber has reached a decision in the matter and is not permitted to award the contract until 2 weeks have elapsed following the decision. If he goes ahead and does so anyway, the premature contract is void.

The decision of the chamber of public procurement is an administrative act pursuant to Section 114 GWB.

4.1.3 Immediate Complaint

The party on either side of a complaint has the right to challenge the decision of the chamber of public procurement if it does so immediately. The deadline is 2 weeks. The complaint must be issued to the Regional Court of Appeals (*Oberlandesgericht*) with jurisdiction for the region in which the chamber of public procurement has its seat. If the immediate complaint is filed in a timely manner, the timeframe in which the public authority is restrained from awarding the contract is extended by another 2 weeks. However, the public authority does have the right to petition the chamber of public procurements and the court for permission to award the contract before the 2 weeks are over.

4.1.4 Damage Claims

Once the contract has been awarded and provided it has not been declared void, it cannot be rescinded. Bidders who would have had a very good chance of winning the contract but who have lost the bid due to wrongful doing on the part of the

public authority, have the right to claim damages pursuant to Section 126 GWB. Similar rights to claim damages could also result from civil-law statutes such as those contained in the Civil Code. On the other hand, the bidder can also be held liable for damages if he deliberately made wrongful use of his remedial rights in order to cause harm to one of his competitors or in order to delay the procedure out of revenge for not having been awarded the contract himself.

4.2 Remedial Rights in Cases Where the GWB is Not Applicable, Particularly in Orders That are Below the Threshold Amounts

Until now it has been generally held that the bidders hardly had any remedial rights in such cases. The assumption has been that the procurement regulations applicable to public authorities not governed by the GWB and VgV, by virtue of their very nature as purely budgetary regulations, did not provide for any kind of legal protection of the competitors for a public order and that the bidders, therefore, did not have any subjective rights in the procedure. Consequently, the procurement decision in particular was not considered to be an administrative act that could be challenged in administrative courts. According to the opinion that has prevailed until recently, this means that it was not possible for the bidders to derive any rights from wrongful doing on the part of the public purchaser, especially not the right to prevent the contract from being awarded to the wrong bidder, let alone the right to demand its being awarded to the right one. The only recourse a bidder used to have against the wrongful doing of a public authority in a procurement procedure was, theoretically, to claim damages in a civil suit. Such cases have been very rare in actual fact.

Since mid-2005, there has been a different trend. According to a decision by the Higher Administrative Court of Rhineland-Pfalz, recourse to the administrative court system should be open to all bidders in public procurement processes, even in those that lie below the threshold amounts. In 2006, the Federal Constitutional Court and the Federal Administrative Court in Germany decided administrative courts would not have jurisdiction over procurement processes that lie below the threshold amounts. In 2007, the discussion flamed up again, after several decisions of civil courts which provided injunctive relief for bidders in such cases according to civil law. However, at the current time, it remains to be seen what impact the judicial opinion cited here will have on legal opinion in general.

5 Summary and Outlook

The situation at present, especially the relationship between the original national regulations of Germany and the EU supplements and modifications, presents major problems to those who have to work with it in real-life contexts. The patchwork

creation as it stands right now is anything but transparent and easy to interpret, which almost always makes it necessary to rely on the help of lawyers. It contains such a potential for misinterpretation or mistakes that the number of official complaints and review procedures has steadily been climbing over the last few years.

Unfortunately, the German legislature missed the chance to use the European reenactment of the relevant directives in 2004 to completely overhaul its current version of public procurement law, slimming it down and simplifying it.

In 2007, the Council and the European Parliament adopted the Commission's proposal for a directive reviewing EU rules on remedies in the area of public procurement. The new directive amends the old Council Directives 89/665/EEC and 92/13/EEC. The directive improves the national review procedures that businesses can use when they consider that a public authority has awarded a contract unfairly. The Commission proposed the directive in May of 2006. An agreement at first reading between Commission, Council and the European Parliament was reached in June of 2007.

The revision has yet to be assimilated by German law, although some of the new regulations are already stated in German law today. If the German legislature has not done so by November 15, 2009, the new directive will apply directly, in non-converted form.

Distribution Agreements

M. Bihler

1 The Law Pertaining to Commercial Agents

1.1 Source of Laws

The primary source of German commercial agent law is contained in the Commercial Code (par. 84–92c HGB). This law is nearly identical to the commercial agent law in effect in the other states of the European Community. The reason for this standardization is the 1986 enactment of an European Community directive (EC Directive of Dec. 18, 1986 ABl. EG Dec. 12 1986 No. L382/17). This directive, which to a large extent was based on the German model, required the Member States to incorporate the commercial agent law contained in the directive into their own national law. All of the States of the European Community have now done so.

Most of the provisions contained in the HGB pertaining to commercial agents are mandatory; this means that such provisions are deemed to be binding on all principal–commercial agent relationships and any contractual terms to the contrary are void. In addition, even in those areas where the HGB does allow contractual deviations, Par. 305 subsequent of the German Civil Code allow such deviations only if the commercial agent is not unreasonably disadvantaged.

Par. 305 subsequent of the German Civil Code apply to commercial agent contracts because, as a rule, such contracts are standard form contracts which have been drafted by a business enterprise for use by all its commercial agents. Par. 305 subsequent of the German Civil Code serve to compensate for the relatively weaker bargaining position of a party faced with a standard form contract drafted by another through providing the party with certain legal protections. However, this is not to say that no room exists for the tailoring of commercial agent contracts to the special needs of the parties. The following sections will discuss key aspects of the law pertaining to commercial agents and the extent to which deviations there from are allowed.

1.2 Commercial Agent Versus Employee

A commercial agent is an independent contractor whose permanent business is either to act as an intermediary in bringing about direct legal relations between his principal and the third party or to enter into contracts with the third party on behalf of the principal (Par. 84, Section 1, sentence 1 HGB). Whether a principal–commercial agent relationship has been created or whether the “agent” is in fact an employee is primarily a question of whether the “agent” possesses important distinguishing characteristics of independent activity. If this independence is not present, the commercial agent will be viewed as an employee (Par. 84, Section 2 HGB).

Case law holds that the individual circumstances as a whole determine whether the requisite independence is present in any particular case. Criteria for such independence are that the commercial agent (1) is only to a limited extent subject to instructions and (2) bears personal business risk. These criteria are easily met, for example, when commercial agents are free to decide whether they will engage employees or contract workers and if so whom, and if all of the agents’ business costs are paid out of their earned commission. Additional indications that agents work independently include the existence of their own place of business and/or organization. On the other hand, contract terms which limit agents’ choice of employees or impose such a strict reporting duty on the agents that an air-tight control system is maintained raise considerable doubt whether a principal–commercial agent relationship is present.

1.3 Commercial Agent Versus Agent Middle Man

The commercial agent differs from an agent middleman, Par. 93 subsequent HGB, by the criterion that the latter is only entrusted with a fixed number of deals or for a limited period. According to case law, even if a person is entrusted for a longer period, it underlies agent middleman law as long as it is merely in charge for a fixed number of deals during this period.

1.4 Contract Obligations

1.4.1 Commercial Agent

According to Par. 86, Section 1 HGB, the primary obligation of the commercial agent is to act as a middleman in bringing about direct legal relations between the principal and third parties or to enter into contracts with third parties on behalf of the principal. This obligation must be fulfilled with the diligence of a “prudent business person.”

A commercial agent also has a duty to review the financial soundness of new customers. Although not expressly stated in the law, this duty is implied from the

HGB's general requirement that an agent represents the interests of the principal in his arranging and procuring of customers and/or contracts (Par. 86, Section 1 HGB). If the agent failed to screen the economic background of new customers, a principal's interest could be placed in jeopardy. Agents have a duty to ascertain the financial soundness of a former customer, however, only if aware of a delay in payment or other circumstances which impact the customer's credit worthiness.

This duty to review the financial soundness of customers is satisfied by the agent's use of informal methods of inquiry. In fact, a provision in a standard form contract which requires commercial agents to procure credit information at their own costs is invalid. However, if the agent is reimbursed for the costs incurred, the parties may stipulate in the commercial agent contract that official credit reports be obtained and/or credit research be conducted.

Another important duty imposed on the commercial agent is to provide the principal with all necessary information. This duty includes in particular the obligation to promptly inform the principal of all successful arrangements or procurements of business. The exact type of information the commercial agent must transmit is determined by the application of an objective standard. The duty to report should not be so extensive and detailed that it collides with the independence of the commercial agent. On the other hand, the parties may establish a reporting system.

Another duty which is implied from the law's requirement that the agent protects the interests of the principal is the duty not to simultaneously work for the principal and for a third person who is involved in the same sphere or scope of business activity as the principal. The issue here is not whether or not the commercial agent's breach of this duty has actually caused the principal damage. Rather, activity which is in competition with the principal's business is prohibited because it disturbs the important relationship of trust which should exist between a commercial agent and a principal. While this duty flows from the law itself, generally a competition prohibition will be contractually agreed to by the parties in writing. In the event of a breach of the agent's duty not to work for a competitor, the principal has the right to terminate the commercial agent contract without prior notice. The principal may also seek contract penalties if they have been agreed to in the commercial agent contract.

Sometimes the commercial agent may also be charged with duties which are atypical for commercial agent activities and which extend beyond what is normally expected of an agent. The imposition of such additional obligations (for example, the duty to stock goods) raises the issue of whether or not the commission is adequate to compensate the agent for the extra duties or whether or not additional claims for remuneration exist.

1.4.2 Principal

Among other duties, the principal must provide the commercial agent with all that an agent reasonably needs from a principal in order to fulfill his responsibilities. This duty includes, in particular, the responsibility to keep the agent thoroughly informed (Par. 86a, Section 2, sentence 1 HGB).

However, principals remain free to independently manage their businesses and are, therefore, under no obligation to involve commercial agents in this process. Decisions regarding production, marketing and sales, quality and price of goods are exclusively the province of the principal.

The only limitation to the principal's exclusive management right is the arbitrariness prohibition. For example, if the principal arbitrarily and without a valid reason, discontinues or suspends production, commercial agents must be advised in advance. If the principal fails to provide such advance notice, then the agents may be entitled to damages.

1.5 Commercial Agents' Commissions

1.5.1 General, Regional and Sole Agents

According to Par. 87, Section 1 HGB, the commercial agent is entitled to a commission on all contracts entered into during the time that a commercial agent contract is in effect and which are either (1) the result of the activity of the agent or (2) entered into with a third party who the agent had previously contacted regarding the same type of goods. Under this standard, the agent's activity need not be the sole or the primary cause of the contract between the principal (or the dealer on the principal's behalf) and customer. It is sufficient if the agent's actions are only one of the reasons for the contract. In addition, the agent is entitled to a commission on all reorders or subsequent contracts unless the commercial agent contract specifically and expressly provides otherwise.

Often a type of commercial agent known as a regional agent will be assigned a specific area and/or circle of customers. In this case, the agent is not only entitled to a commission on contracts he or she has helped to secure, but rather on *all* contracts with customers from this geographic area or customer circle which are entered into during the time that the commercial agent contract is in effect. In addition, regional agents can require that the principal ensures that their territory is respected by other agents.

Another common type of commercial agent is the "sole" agent ("exclusive agent"), who, as the name suggests, possesses the *sole* right to represent the principal in an assigned geographic area. Like the regional agent, the sole agent is entitled to a commission on all contracts with customers from his or her assigned territory. Unlike regional agents, however, sole agents enjoy the additional right that even the sales and marketing activity of the principal in the agents designated territories is excluded unless the commercial agent contract specifically provides otherwise.

1.5.2 Overhang Commission

Under the law, the commercial agent is entitled to a commission on sales which occur after the expiration or termination of the commercial agent contract if the

agent has arranged or procured the sale or taken such preparatory steps that the sale can be said to be primarily the result of the agent's activities, or, if before the agent-principal relationship came to an end, the principal had received an offer to buy from a third person (Par. 87, Section 3 HGB).

This right of agents to a payment of commission on sales occurring after the expiration of their commercial agent contract ("overhang commission") can, however, be contractually modified or eliminated if a factually justifiable reason for it exists. According to a precedent case ruling, a justifiable reason exists if, at the beginning of the contract term, the commercial agent receives commissions on sales that his or her predecessor initiated, and the agent's successor likewise receives commissions on any sales occurring after the agent's contract expires.

1.5.3 Unilateral Changes to Contract Terms

As a rule, contract provisions which allow the principal to make unilateral changes during the duration of the commercial agent contract, such as unilaterally altering the agent's rate of commission, the borders of the assigned geographical area or the products which said agent handles on behalf of the principal, are unenforceable. The only options for a principal who wishes to make a unilateral change are: (1) in the case of a commercial agent contract with an unspecified duration, to make use of a special type of termination known as a "Änderungskündigung," which is a termination of the contract with the simultaneous option of renewal under altered conditions or (2) to connect the reservation of right to make unilateral changes to a specific reasonable set of circumstances, such as, the reduction of the assigned geographical area if sales are reduced.

1.5.4 Manifestation of the Agent's Right to a Commission

Under Par. 87a HGB, the commercial agent has a right to a commission at the time the sales transaction is carried out. This means that the agent's entitlement occurs as soon as the principal has delivered the goods, regardless of whether or not the customer has paid for them. However, the parties can contractually deviate or modify this rule (Par. 87a, Section 1 HGB). One typical modification is for the parties to agree that the agent is not entitled to a commission until the third person has acted on the sales contract, that is, until the customer has actually made payment. This particular modification, which is generally regarded as enforceable, results in the commercial agent bearing the full risk for the execution of the contract.

1.5.5 Miscellaneous Mandatory Rights Impacting Agent's Commission

If commercial agents agree to guarantee the payment of the procured customers ("delcredere agent"), they are entitled to an additional commission (Par. 86b HGB).

Another mandatory provision regarding the commission is contained in Par. 87a, Section 3 HGB. According to this provision, commercial agents are entitled to a full commission on any contract they have entered into with the customer, even if the contract terms are subsequently partly or completely not fulfilled, provided that the partial or total lack of fulfillment is due to circumstances for which the principal is responsible.

Par. 87 of the HGB ensures that commercial agents are remunerated for their efforts when, based on reasons that have to do with the relationship between the principal and the third party, the contract is not executed. Contract terms which attempt to deviate from this law are unenforceable. Examples of this are a stipulation that the agent is not entitled to a commission in the event the principal would suffer a loss if the contract was executed, or a clause which requires the agent to bear the costs in the event of a legal dispute with the third party.

On the other hand, agents are not entitled to a commission if the contract is not carried out due to reasons for which the principal is not responsible. Such a situation may arise, for example, if a customer's default in payment results in the principal being legally entitled to refuse performance.

If the principal has reserved the right of "supply to ourselves" ("Selbstbelieferung") then the customer has the right to demand delivery of the goods contracted for only if the principal is able to acquire them. While such a reservation excuses the principal's performance vis-à-vis the customer, the agent nevertheless remains entitled to a full commission on the contract despite the principal's inability to perform. Because the agent has a right to rely on the principal's ability to deliver the goods which the agent has marketed in good faith, the fact that a supplier fails to provide the goods to the principal is deemed to be a circumstance for which the principal is responsible.

1.5.6 Amount of Commission

The amount of the commission is usually agreed to by the parties in their commercial agent contract. In the event that the contract fails to address this issue, the customary rate must be paid (Par. 87b, Section 1 HGB).

Ancillary costs for freight, packaging, duties and taxes which the principal incurs and separately lists in the customer's invoice are not considered a part of the customer's payment for the goods themselves and, therefore, have no influence on the amount of the agent's commission. On the other hand, ancillary costs which are passed on to the customer but not separately listed in the invoice are considered a part of the contract price upon which the agent's commission is based.

One exception to these general rules regarding the impact of ancillary costs on the commission is the value-added tax. Even though VAT is separately identified in the invoice, it is deemed a part of the customer's payment for the goods and thus influences the amount of the agent's commission (Par. 87b, Section 2 HGB). However, the parties may (and usually do) contractually deviate from this law and instead agree not to consider the amount of value-added tax in determining the agent's commission.

A discount or other type of price reduction granted the customer has no impact on the amount of the commission. A provision in the commercial agent contract to the contrary is unenforceable. Finally, even if the parties agree to a reduction in the commission in the event the principal helps the agent to secure a contract, a Federal Court ruling holds that such an agreement is likewise of no force and effect.

The agent's commission must be calculated and paid on a monthly basis, however, the parties may agree instead to a 3-month payment period. The actual payment to the agent must be made no later than the end of the month which follows the relevant accounting period (Par. 87c, Section 1 HGB).

Agents have a right to all information contained in the principal's books or ledgers which are relevant to the calculation of their commission; for example, the names and addresses of all customers who placed an order, the type, amount and price of the sold goods, and information pertaining to returns and failures to carry through with transactions (but not, however, the reason for such returns or failures). Providing the agent with copies of customers' invoices alone is not sufficient. Because the agent's right to information is only extinguished when both parties are in agreement regarding the commission, it is recommended that the principal collect the necessary information at the time the agent's commission is calculated and then send such information to the agent along with the commission payment.

These laws regarding the settlement of the commercial agent's account are obligatory, and any agreement by the parties which limits the agent's legal protections in this regard are unenforceable. Monetary claims of either party arising out of the principle-agent relationship are subject to a 3-year statute of limitations. The period begins to run with the end of the year in which the claim becomes due. It is usually not possible for the parties to bind themselves to a shorter limitations period, at least in a standard form commercial agent contract subject to the Law for the Regulation of Standard Business Terms), even if the shortened limitation period applies to both parties.

1.6 Termination of the Commercial Agent Contract

A commercial agent contract with an unspecified duration or term may be terminated without cause by a 1-month advance notice in the first year of the contract, a 2-month advance notice in the second year, a 3-month advance notice in the third to fifth year, and a 6-month advance notice after the fifth year. The termination's effective date is the last day of the calendar month, unless the parties have provided otherwise in their contract (Par. 89, Section 1 HGB). The length of the notice period can be extended by contract but not shortened. Even if the commercial contract provides for a probationary period, the above stated notice periods must be provided.

The Federal Court has ruled that it is not possible to terminate only a part of the commercial agent contract, unless the parties have agreed otherwise and such termination is limited to a part of the agent's activity that is capable of being separated from his or her other activities. A termination of the commercial agent contract for

an important reason (due cause) can be immediately effected by either party without the necessity of providing advance notice (Par. 89a HGB). This termination right can neither be excluded nor limited by contract.

Important reasons for termination are facts which result in it being unreasonable to expect a party to keep the contract in force until the advance notice period has expired. Advance agreements stating which specific types of factual situations constitute important reasons are somewhat problematical. Basically, an important reason is a situation which has resulted in a shock to the relationship of trust between the principal and agent. For example, important reasons for the agent to terminate without notice could be an arbitrary, significant reduction of the commission rate by the principal or exploitation of the agent's efforts by a firm in which the principal has an ownership interest. Important reasons for the principal to terminate without notice could be, for example, the agent's definitive, unauthorized refusal to work, an agent's attempt to entice the principal's other commercial agents away from the principal in order to benefit a third party, or placing fictitious customer orders. In addition, acts by the agent which involve breaches of trust are particularly susceptible of forming an important reason for termination. Insulting, libeling or slandering the principal, criminal activity, intoxication on the job as well as the failure to notify the principal of transactions or of certain facts which could be of particular importance to a principal are examples of acts which can form the basis for a termination of the agent without notice.

If an important reason for a termination exists, then the termination must take place within a "reasonable" amount of time. Although the 2-week time limit set by Par. 626 of the BGB is not applicable to commercial agent law, it is advisable to observe the 2 week limit in order to avoid legal difficulties later.

A party who terminates the commercial agent contract without notice may be liable for damages, although it would *not* have been unreasonable for such party to keep the contract in force until the expiration of the notice period. For this reason, a commercial agent contract should not be terminated without notice without careful examination of the cause for termination. The trend in the case law is to limit the grounds which render it unreasonable to keep the contract in force until the advance notice period has expired.

Finally, if the principal wishes to implement a termination without notice based on the agent's performance (as opposed, for example, to conduct which involves a breach of trust), then, prior to the termination, the agent is first entitled to a warning. This warning must be in writing and describe the conduct which the principal finds contrary to their agreement, as well as contain a statement that in the event such conduct is continued, the contract will be terminated.

1.7 Compensatory Claim of Agent for Loss of Clientele

A commercial agent's work results in the development of a regular group of customers or clientele. This valuable service to the principal is not only remunerated through

commissions, but also through compensation to the agent for his loss of clientele, at the time the commercial agent contract is terminated (Par. 89b HGB). Because the amount of this compensatory payment very often leads to a disagreement between the parties at the time the contract is terminated, it will be discussed here in detail.

First of all, this compensatory claim is not required upon the termination of all commercial agent contracts. According to Par. 89b, Section 3 HGB, the payment is not required when it is the agent who terminates the contract, unless said termination is justified by an important reason for which the principal is responsible. The Federal Court has ruled that in the case of the above-mentioned “Änderungskündigung” which is not accepted by the commercial agent, this one will not lose his compensatory right, as it was the principal who gave notice. It is important to note that agents are always entitled to compensation if their contract is terminated for reasons of age. Likewise, if the principal justifiably terminates the contract based on important reasons for which the agent is responsible, the agent’s compensatory right is forfeited. According to case law, the compensatory right is not forfeited if there is an important reason, but the notice does not indicate that it is based on an important reason. This holds both for termination by the principal and the commercial agent.

Terminations where no compensatory payment is required are the exception. Usually, when a commercial agent contract is terminated, it is a termination initiated by the principal with notice. In such a typical termination, agents are entitled to a compensatory payment upon request if: (1) during the contract term they have made contacts with new customers and (2) such contacts could lead to considerable advantage for the principal following termination of the principal-agent relationship (Par. 89b, Section 1 HGB).

The first requirement listed above (contact with new customers) is also deemed to be met if, as a result of the agent’s activities, the business relationship with a former customer who had not been originally secured by the agent is significantly intensified. Generally, a significant intensification of a business relationship can be shown if, during the duration of the commercial agent contract, the sales figures corresponding to such previously secured customer are doubled.

If the principal demands that a new agent pays an “admission fee” for the right of assuming representation of the existing customers of an agent who is leaving, this fee has no impact on the question of whether or not the departing agent had initially contacted and/or intensified relations with these customers. Also, the new agent is not entitled to have the amount of the “admission fee” returned in the form of a compensatory payment, in the event his or her contract is subsequently terminated. However, it is possible for the parties to specifically agree that upon termination, the agent is entitled to a minimum compensatory payment equal to the amount originally paid by the agent as an “admission fee.” Such an agreement is sometimes included in the parties’ contract in order to protect the agent who has paid an admission fee from an unexpected early termination of the commercial agent contract.

The second requirement listed above (provision of considerable advantage to the principal) is met upon a showing that, as a result of the termination of the commercial agent contract, the agent will lose commissions on existing or future contracts with new customers originally secured by the agent, and/or with former customers

for whom the agent has been successful in significantly increasing the business relations with the principal. The amount of the agent's loss of commissions is generally equivalent to the advantage the principal would enjoy if no compensatory payment was required. Therefore, a forecast must be made of the future development of the business relationships between the principal and such customers and how much commission the agent would have earned if the contract with the agent had not been terminated. The question of whether or not and to what extent changes in the established clientele can be expected are particularly important in making this forecast.

The determination of the amount of this compensatory payment must also take into account all circumstances which bear on the fairness of the payment. In this connection, the reasons for termination, the agent's family situation and support obligations as well as the question of what extent the product has developed a strong market appeal due to the principal's advertising outlays should be considered.

The first step in calculating the amount of the agent's compensatory payment is to determine the agent's total annual commissions earned in the last year of the principal-agent relationship on contracts with new customers or with existing customers whose business relations with the principal the agent succeeded in considerably intensifying. The second step is to determine how many years in the future the principal can expect to do business with this particular customer pool. It is generally assumed that such relationships will continue for 2–5 years beyond the termination date of the commercial agent contract. The number of years or forecast period chosen depends on and corresponds to the overall rate of customer fluctuation one can expect in the particular situation. For example, if the parties choose a 4-year period, they assume that the principal will annually lose 25% of the new or intensified customer relationships which are attributable to the agent's efforts.

The third step is to take the figure derived from step one and project it over the forecast period in order to determine the agent's gross compensatory payment. The sum determined in this way represents the gross compensatory payment. The fourth step is to reduce this gross sum by the amount of interest advantage which will accrue to the agent, due to receiving future commissions on a lump-sum basis. The fifth step is to consider if further reductions should be made based on reasons of fairness and, if so, to make such reductions.

Finally, the sum which results from the fifth step must be compared to the highest amount of compensatory payment allowed by law. This comparison is necessary because according to Par. 89b, Section 2 HGB, the compensatory payment may not exceed the average yearly commissions or other income earned by the agent in the last 5 years.

The laws pertaining to this compensatory payment are mandatory. Any attempt by the parties to avoid the compensatory payment or to provide for a reduced payment *ahead of time* are strictly without legal effect. The only way that the parties may contractually impact this compensatory payment is through an agreement entered into after the commercial agent relationship has been terminated.

In such a post termination agreement, it is customary for the agent and principal to determine the amount of the compensatory payment. The parties may also extinguish

the agent's right to a compensatory payment altogether, if they agree that a third person shall take the place of the former commercial agent and this substitution occurs. Again, it is important to emphasize that such agreements are only possible after the commercial agent contract has been terminated.

Commercial agents must assert their claims to compensatory payments within 1 year following termination of the commercial agent contract or they lose them. It is also possible for the agent to assert his claim prior to the termination of the contract. The law neither prescribes a particular form for the assertion of this right, nor requires that it be asserted through the courts.

1.8 Non-Competition Agreements

The principal and agent may legally enter into an agreement that the latter shall be restricted in his or her business activities for up to but not exceeding 2 years from the termination of the commercial agent contract. Any such restriction on competition must be limited to the territory or the clientele of the agent as well as to the product or other matter that was regularly sold on behalf of the principal.

If a competition agreement is reached, however, the principal is required to pay the agent a reasonable compensation which corresponds to the length of time the agent's activities are restricted (Par. 90 a, Section 1 HGB). This compensation serves the purpose of ensuring that the agent is provided with the necessities of life during the time the restriction is in place and represents consideration for the agent's promise not to compete.

The law does not address the amount of compensation the principal must pay. A reasonable amount is determined by considering the disadvantages that the agent incurs through the competition restriction and as well as the corresponding advantages for the principal. Other earnings of the agent are not deducted from the compensation; the fact that the agent has other earnings is considered in determining whether the compensation is reasonable.

Up until the time the commercial agent contract expires or is terminated, the principal may give written notice relinquishing his right to a non-competition agreement. Six months following the written notice, the principal is relieved of the duty to pay. Further, the agent forfeits his right to compensation if the principal terminates the contract with or without notice based on important reasons for which the agent is responsible. To ensure that the agent complies with a non-competition agreement, it is possible for the parties to agree to the imposition of contractual penalties.

1.9 International Commercial Agent Law

If the principal's main place of business is in a foreign country and the agent represents the principal in Germany, the parties may contractually determine which country's law

will apply. According to the Introductory Act to the Civil Code (“Einführungsgesetz zum BGB”), however, their contract may not violate the fundamental principles of German law designed to protect the rights of employees (Art. 30 EGBGB). This provision is applicable to commercial agent contracts despite the clear recognition under German law that commercial agents are independent contractors and not employees.

If this conflict-of-law issue has not been resolved by the parties in their agreement, the law of the place which has the most significant relationship to the contractual relationship applies. Generally, this question is resolved in favor of the main place of business of the agent and not of the principal (BGHZ 53, 332).

Law-suits may be brought only to that court where the main place of business of the agent is, Art. 5 lit. 1b of the European Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. This applies to actions of the principal as well as to actions of the agent, especially for compensation.

In situations in which agents, regardless of where they actually reside, operate outside of the European Community, the parties may include terms in their contract which are contrary to all of the requirements of the German commercial agent law. In other words, the mandatory provisions of German commercial agent law (including Par. 30 EGBGB) are not applicable. The parties are free to agree to subject their agreement and the resolutions of disputes arising from it to the law of a foreign, non-European country.

2 The Law Pertaining to Authorized Distributors

Authorized distributors are individuals or entities who, on the basis of a long-term business relationship, buy and resell goods in their own name and on their own account. Because of the existence of a long-term contract between authorized distributors and manufacturers (or importers), the rights and duties of the parties resemble that of commercial agents. In many particular respects, the interests of authorized distributors and commercial agents are frequently similar. The courts have taken this similarity between the two types of independent contractors into account and in certain cases applied the laws pertaining to commercial agents to authorized distributors.

In particular, the case law holds that according to Par. 89b HGB, authorized distributors are entitled to compensatory payments for the loss of clientele at the termination of the manufacturer–distributor relationship if the following two requirements are met:

- The legal relationship between the authorized distributor and the manufacturer is more than a mere buyer-seller relationship. This is the case when authorized distributors have become so integrated in the marketing organization of the manufacturers that their rights and duties resemble those of commercial agents and

- The authorized distributors are required to turn their customers over to the manufacturers at the time the distributor–manufacturer relationship comes to an end and the manufacturers are immediately able to make use of the customer accounts to their own business advantage should they so desire

The contract between the parties is the starting point for determining whether authorized distributors are integrated in the marketing organization of the manufacturers. If authorized distributors are made responsible for certain marketing areas and if they are ascribed certain duties such as sales promotion or fostering the good reputation of the brand, this sufficiently indicates that an integration has occurred. The same applies if authorized distributors are required to pay advertising costs, maintain a stock or are induced to sell products at the manufacturer’s or importer’s recommended price. Moreover, in each case a careful examination should be made to determine if the actual day-to-day dealings of the parties deviate from their contract and whether the actual practices have, in effect, supplemented or altered the formal contract.

According to case law, it is quite easy for authorized distributors to prove that they are contractually bound to turn over their customers upon termination of their contracts. It is enough, for example, to show that they regularly turned their customer addresses over to the manufacturer during the time the contract was in effect, even if the manufacturer did not insist on being given the addresses or have any intention of using them. Case decisions have also shown that it is enough if invoices or their supporting documents, sales reports (daily or otherwise prepared), weekly status reports or customer questionnaires are transmitted per distributor contract to a marketing firm retained by the manufacturer or importer.

Manufacturers and importers who wish to avoid the very negative consequences of the analogous application of Par. 89b HGB requiring a compensatory payment for the loss of customers must pay very strict attention to the drafting of the distributor contract. In particular, the contract must expressly state that the manufacturer (or importer) has no interest in the transmission of customers and the reasons why this is so.

For agreements concerning the manufacturer–distributor-relationship in the motor vehicle sector in particular, it is to say that they must not violate the European Commission Regulation No. 1400/2002, which establishes exceptions to the European Community competition law.

However, if the authorized distributor is contractually bound to transmit customers, the authorized-distributor law provides that the distributor’s right to a compensatory payment cannot be contractually excluded. In order to preserve this claim, the authorized distributor must raise it within 1 year following the termination of the distributor contract. Moreover, as with commercial agents, authorized distributors who terminate their contract due to age or sickness and for whom the continuation of their sales work would be unreasonable are entitled to compensatory payments for the loss of customers. If the manufacturer terminates the distributor contract, the compensatory payment is excluded only if the termination was based on serious cause.

The calculation of the amount of the compensatory payment for the loss of customers is made in essentially the same manner as described above in connection with commercial agents. In the case of authorized distributors it is especially important to reduce the compensatory amount based on fairness reasons in order to account for that portion of the product's market appeal which is attributable to the manufacturer's (or importer's) advertising expenses. As a rule, this will result in the compensatory amount being reduced by 25%.

Private Public Partnerships

K.F. Sturmfels

1 Introduction

The Term “Public Private Partnership” (PPP) is used for a long-term cooperation in the form of contracts between the public and private sector of the economy, for services that are within the public’s scope of duties. The resources required for the realization of a “Public Private Partnership” – mostly infrastructural projects – are keyed in one project for which the existing risks are shared proportionately and cost-advantageously to the partners’ individual competence of risk-management.

The term Public Private Partnership does not stand for a distinct type of contract. In fact it is a collective term for different cooperation schemes such as business management, BOT (Build, Operate, Transfer), business transfer, short-term operator, lease, and management schemes.

PPP projects primarily focus on building, redevelopment, extension, or modernization of infrastructural services by the public sector, for example, of schools, administration buildings or hospitals. Normally the contractor of the private sector has the necessary duties of planning, building, financing and operating the project, and fulfils his responsibility of providing services for the entire time of the project’s existence. Beyond that, the private sector contractor takes over additional services such as catering and security, depending on the instructions of the public sector contractor.

Characteristic for PPP schemes is the transfer of risks to the private businesses. As contractor, the private enterprise assumes responsibility for the asset’s financing entirely or in part. Not only the building but the subsequent operation of the asset is then reimbursed.

In contrast to the ordinary planning and execution of construction projects, there is no separate call for tenders for every part performance within a PPP project, but the public sector’s contractor for the project purchases an entirety of services. Therefore, the PPP project is not only a financing plan, but rather a comprehensive model for organization and procurement. Accordingly, the public sector no longer invests in concrete and brick, but purchases the services required to be provided (provision of office space, school buildings and hospitals, etc.) for a predefined user fee. This fee contains components for wear and tear, operation

maintenance, refinancing of proprietary and outside capital, return on proprietary capital, and an appropriate profit and interest calculation for the funding.

A PPP project is subjected to a so-called life cycle consideration. Even in the planning stage, the expenses for operation and maintenance must be taken into consideration.

The period of the contract depends on the purpose of the PPP project, but, as a general rule, should not fall below 20–30 years. The volume of a PPP project should not fall short of € 10 to € 15 million.

2 Starting Point

Due to an increasing deficit in the public budget and the related decline of capital expenditure there is a considerable stop of redevelopment and modernization in the area of public infrastructure in Germany.

The model for PPP projects in Germany is the Private Finance Initiative (PFI) developed in Great Britain. At the beginning of the 1990s, lack of funds lead to the realization of investments of the public sector with the help of the private sector of the economy. Today about 20% of all public investments in Great Britain concerning schools, hospitals and road construction are realized in the form of PFI plans.

In international relations, such projects are often referred to as “DBFO projects” (Design-Build-Finance-Operate).

Experiences from Great Britain, the Netherlands and other countries show that the use of PPP projects can achieve a significant saving of expenses. Furthermore, it is advantageous that the public sector official has to deal only with one single contractor regarding a PPP project. The typical structure of a PPP project earmarks that the private contractor and investor binds all performing parties to him by establishing a partnership for the project. In this way the user’s tasks, are transferred to the private investor, minimizing the public contractor’s duties.

The benefit of PPP projects is their financing. Private pre-financing results in a postponement of the public authorities’ obligation to pay to the period of the asset’s operation. In addition, the specific know-how of private enterprises can be utilized for the invitation to tender, the building and the operation of infrastructure projects.

3 Participants in a PPP Plan

The public sector official transfers the tasks such as planning, construction, financing, and operating to a single contractor established in a partnership for the project. The partnership for the project is founded by the contractor who succeeded in the call for tenders (possibly a syndicate formed by several companies) and represents the direct contact for the public sector’s official through the project’s duration.

Private partners are involved in PPP projects on a long-term basis and supply the partnership's equity capital. They also provide the management and lead the project's partnership. They control the performance of construction and operation. These tendered performances are normally assigned to subcontractors.

The partner for construction assumes the performance of planning and construction. The combination of both tasks reduces the number of intersections, allows early coordination between planning and building and consequently provides profitable results.

The operator of the facility management is already integrated in the partner for construction's activities during the development of the project. In this way experience regarding expenses of operating the property can be taken into consideration at an early stage of the project.

The operator purchases the plot of land or takes over the property after complete performance of construction within a so-called "permitting-the-use plan" or "provision plan" and takes care of the operation during the duration of the project's contract. These performances may range from technical property management and infrastructure management to commercial property management. In addition to that, the operator may also take care of further services like catering, cleaning and security, etc.

4 Essentials of the Legal Relationship Between the Public Sector and the Private Investor

PPP plans either emerge from the establishment of a joint company (shares may be distributed differently depending on the project) or the foundation of a partnership fulfilling services that are within the public's scope of duties. Determination of the project's purpose as well as the spread of task and risk are defined in a partnership agreement. Above that, primarily in construction engineering – the purpose of the project can be determined in creating a service or licensing agreement between the public sector and an all-private partnership.

4.1 Contracts

The public sector official and the contractor in the private sector conclude a comprehensive contract for the planning, the construction, the financing, and the operation of the project. Usually these contracts are referred to as licensing agreements, construction and service agreements, PFI or PPP contracts. Great importance is attached to the definition of the project's performances, for example, the room temperature, cleaning, water and electricity supply and the like. The payments are made dependent on the accomplishment of the performances' requirements.

The relationship between the project's partnership and the operator of the object is defined in the operator/property management contract. It stipulates the operator's

all-embracing duty for operation, maintenance and repair of the object as well as other services.

The financing conditions are stipulated in the form of loan contracts for the project's outside capital.

4.2 Model of Operation

It is recommended to conclude a skeleton contract between all participating parties, that includes all important principles for the cooperation in every part of performance as well as in all general provisions. Secondly, the provisions for every part of performance have to be defined in individual contracts or descriptions of the performance. Accordingly, there is a structure in two hierarchies. Particularly high demands are to be placed on the specification of content and scale of the performances to be rendered. It is always advisable to define any description of a performance as precisely as possible.

4.3 Service-Level-Agreements

Service-Level-Agreements are usually defined as quality standards for performances based on measurable quantities. Furthermore, such agreements provide provisions for sanctions in cases of non-performance or defective performance. Therefore, Service-Level-Agreements belong to the key-elements of any contract.

5 Outline Conditions in Germany

The cooperation between public authorities and the private sector in the sense of public private partnerships, practiced successfully in other European countries, is still in its infancy by comparison in Germany. The legal framework used to constrain the realization of PPP projects in the past. Questions of the awarding and preparation of contracts and the execution of those projects were long unsolved. Provisions of tax law discriminated PPP schemes in favor of projects built by public authorities on their own responsibility. There were further obstructions with regard to financing as well.

Criticism eventually led to legislative activity. The Act for the Acceleration of the Realization of Public Private Partnerships and the Improvement of the Legal Framework for Public Private Partnerships (PPP Acceleration Act – “ÖPP-Beschleunigungsgesetz”) came into force as of September 1, 2005 and resulted in amendments to several German acts. It aims at the elimination of obstructions and ambiguities previously impeding the implementation of public private partnerships in Germany. The act's most important provisions are outlined in the following.

5.1 Act Against Restraints on Competition and Regulations for Awarding Contracts

In adding Section 99 (6) to the Act Against Restraints on Competition (*Gesetz gegen Wettbewerbsbeschränkungen*), a clear picture has been achieved with regards to the definition of mandates that are concerned with supplies as well as services and construction work: While the distinction between supplies and services is made according to their respective value, services and construction work are defined according to the contract's priority independent from their respective values. These definitions follow the jurisdiction of the European Court of Justice (ECJ).

Furthermore, the amendments to Section 101 GWB ("*Gesetz gegen Wettbewerbsbeschränkungen*" – Act Against Constraints of Competition) have brought about important changes. The section's first paragraph regulates the kinds of award procedures. In accordance with the new EC Procurement Guidelines (Directives 2004/17/EC and 2004/18/EC), the so-called "competitive dialog" was introduced as a new independent procedure.

This is an award procedure of three stages, consisting of a competition at the pre-selection stage, a dialog stage, and a final tender stage.

According to paragraph 5, a competitive dialog is a procedure to be applied to awarding particularly complex contracts. Within this procedure an invitation to participation is followed by negotiations with selected enterprises about all particulars of the contract. Contracts of particular complexity are for instance major integrated traffic infrastructure projects, huge computer networks, or projects which involve complex funding whose legal and financial constructs cannot be described in advance. The newly adopted procedure is meant to guarantee competition as well as respond to the requirement of sufficient flexibility in providing a continuous dialog with the enterprises involved, covering all aspects and corresponding with the special complexity of the contract.

The procedure of competitive dialog is explained in more detail in the newly added Section 6a VgV ("*Vergabeverordnung*" – Regulation on the Award of Public Contracts). However, the newly introduced award procedure is not the only permissible one to be used for contracting out a PPP project, rather another option. The future bidder is meant to cooperate early on, even in determining the technical specifications provided by the contracting body.

If the companies involved in the competitive dialog incur costs for the preparation of drafts, diagrams, drawings, or other documents, newly added Section 6 (7) VgV provides the basis for claims against the contracting body for the reimbursement of respective expenses.

The Regulation on the Award of Public Contracts was amended in other sections as well.

The provisions of the Contracting Regulations (*Verdingungsordnung für Leistungen, VOL/A*) are now applicable to awarded supply contracts and contracts for services.

However, the previous requirement for a personal contribution by the contractor has been abandoned because, according to German Courts, the contractor had been

obligated to deliver a substantial part of the contractual performance as a personal contribution. Nevertheless, the European Court of Justice held that the obligatory personal contribution is not compatible with European Community Law. Accordingly, tenderers cannot be excluded because they have referred to the technical or economic capacities of a third party in the award procedure if they furnish proof that they may enter into obligations using that third party's capacities. This regulation implicates that contractors may use subcontractors for the performance of contracts.

With regard to PPP projects, the amendment implicates that the tenderers do not have to be building companies. By the abandonment of an in-house performance ratio, project funding by institutional investors – an important option especially for the realization of PPP projects – has been made easier as well.

Another facilitation of PPP projects is brought about by the amendment to the Regulation on the Award of Public Contracts in Section 6 (2) no. 1. This provision has adjusted the awarding practice insofar as tenderers in competition must not be asked anymore to submit a bid in the legal form of the future project company at this early stage. This practice, deemed legitimate until the amendment came into effect, particularly burdened the medium-sized businesses due to the expenses involved in the company formation, affecting PPP projects as a consequence. After the act's revision, the contracting body's demand in awarding the contract to several companies that the bidding consortium assume a certain legal form is justified only if this proceeding is necessary for the contract's execution.

5.2 Private Highway Construction Financing Act

Within the framework of this Act, the Private Highway Construction Financing Act ("Fernstraßenbaufinanzierungsgesetz" – FStrPrivFinG) has been amended as well. On the basis of this provision it is possible to assign the building, maintenance, operation, and funding of a certain section of road to a private enterprise for a certain time. The private business is refunded by its authorization to collect toll from the users of the section of road. According to Section 2 (1) sentence 4 FStrPrivFinG, the revision provides private operators with the opportunity to refinance themselves by private law fees. Alternatively, the toll can also be imposed as a public law charge. With regard to the costs to be considered for the determination of the toll's amount, the respective calculation period in the sense of Section 2 (3) FStrPrivFinG must be taken as a basis, not the term of the license.

5.3 Federal Budget Code

In compliance with Section 7 (2) sentence 1 BHO ("Bundeshaushaltsordnung" – Federal Budget Code), the spreading of risks involved shall be taken into consideration in the assessment of a project's economic efficiency.

The prohibition to sell, stipulated by Section 63 (2) BHO, according to which federal assets may only be sold if they will not be needed for the fulfillment of federal functions in the foreseeable future, has been moderated. By the addition of a new sentence to Section 63 (2), it is now legitimized that property which is still required for the fulfillment of federal functions may be sold for long-term self-operation if federal functions can evidently be executed more cost-efficiently by this measure. Until this revision, sale and leaseback transactions were problematic. The amendment to the code removes this obstruction.

5.4 Tax Law

The framework of PPP will make it necessary in most cases for the public authorities to entrust the investor with real estate for a designated time. Section 4 no. 9 Grunderwerbssteuergesetz (Land Purchase Tax Code) contains a specific provision for tax exemption. Before the revision came into force, this course of action led to taxation (property tax) twice, namely at the time of the investor's entrustment and at the time of property reassignment to the public authorities. By the revision, this proceeding of assignment and subsequent reassignment is treated as if no purchase had happened in the first place, i.e. as if the public authority had continued to be owner over the entire term of contract.

5.5 Investment Act

The Investment Act (Investmentgesetz) is made applicable to PPP projects by the following amendments: In Section 67 (2) of the Investment Act, the institutional property funds and investment corporations with fixed capital are permitted to acquire interests and shares in PPP project companies. However, this admission is limited to the operating stage subsequent to the development or redevelopment of the infrastructure projects. The investment is also limited to a maximum 10% of the value of the institutional fund, as the provision aims only at an addition which will not materially alter the nature of an open real estate fund.

Furthermore, amendments to this provision expanded the investment opportunities of "open separate estate property funds" to allow the purchase of usufructuary rights of properties which are used to fulfill public duties. Up to now an "open separate estate property fund" could only invest in real estate, if it acquired either the title or leasehold rights of the property.

However, many states' ordinances did not permit local authorities to sell property that was needed for public duties to private contractors or to encumber such property with leasehold rights. Therefore "sale and leaseback" operations between local authorities and property funds have been possible only to a limited extent.

6 Outlook

The act shows the German legislature's intention to implement PPP projects into German administrative practice for increased application. If this opportunity will be seized by the parties involved, i.e. the public authorities and the business community, cannot be definitely said yet. However, it can be stated that the PPP scheme has often been applied in the sector of cleaning contractors over the last years, owing to an increasing public budget and liquidity squeeze. The popularity of PPP schemes in other countries is an indication for a similar future development in Germany. The legislature has made the first step by the provision of a number of statutory facilitations. If construction projects in particular will be realized by means of PPP in the near future depends on the extent to which the administration will mainly consider financial aspects in planning the realization of projects. In view of the squeeze in public households, the structure of choice will quite occasionally be a PPP, as a PPP scheme optimizes both spreading of risks and economic efficiency.

Copyright

C. Gerlach

1 Introduction

1.1 Subject-Matter of Copyright and Legal Basis

Copyright primarily deals with the protection of works of literature, science and art. It is regulated in the German Copyright Act (Urheberrechtsgesetz).

In addition, the German Copyright Act contains provisions regarding the so-called related rights or “neighbouring rights”. The subject-matter of these related rights are services in the cultural field which are not subject to actual protection by copyright protection, for example presentations by performing artists such as musicians or actors, producers of sound recordings and broadcasting organizations. Furthermore, special provisions can be found in the German Copyright Act regarding the protection of software and databases.

1.2 European Law

A “European copyright” does not exist. However, there are various EU directives with a copyright reference which have been incorporated into national law by the member states (including Germany)¹. A selective harmonization of the copyright laws of member states applies within the framework of these directives.

¹ These include inter alia:

- Directive 91/250/EEC dated 14.5.1992 regarding the protection of software;
- Directive 92/100/EEC dated 19.11.1992 on rental and lending rights;
- Directive 93/83/EEC dated 27.9.1993 on satellite broadcasting and cable retransmission rights;
- Directive 93/98/EEC dated 29.10.1993 on harmonisation of the copyright protection period;
- Directive 96/9/EC dated 11.3.1996 regarding the protection of databases (see Sect. VI 2 below on this subject);

1.3 Protection by Copyright Law

The Anglo-American copyright is based on utilitarian considerations. Copyright protection is granted in order to provide an adequate incentive for the creation of new intellectual works (“to promote the Progress of Science and Useful Arts”, U.S. Constitution, art. I, cl. 8, Section 8). In Germany and most other continental European states, copyright is founded on natural law. The author should acquire an ownership – “intellectual property” – of his work with the creation of the work, resulting from the “nature of the object”, simply from the act of creation. This “natural” link between the author and his work is merely acknowledged by statute through the copyright.

Proofs

These different concepts under the philosophy of law lead to some differences between the Anglo-American and the German or continental European copyright. Thus, the author’s moral rights have a special significance in the German copyright, as the “special connection” between the author and his work is ultimately the basis of copyright protection (see below Sect. 4.2). Therefore, the copyright is in essence non-transferable, even if rights of utilisation or licenses can be granted (see below Sect. 5). Moreover, the author is always an individual, namely the actual creator of the work. This applies even if the work was created within the framework of an employment relationship (see below Sect. 3.2).

2 Protection and Requirements for Protection

2.1 Works

In accordance with Section 1 of the German Copyright Act, the copyright protects works of literature, science and art. Section 2 of the German Copyright Act includes a non-definitive list of examples of different types of work. Protected works in accordance with Sections 1 and 2 of the German Copyright Act are works of music and literature, literary works, works of fine art and of architecture, photographs, films and scientific or technical representations such as drawings, plans or maps.

– Directive 2001/29/EC dated 22.5.2001 on copyright in the information society; on the basis of this Directive, the circumvention protection provisions of Sections 95a et seq. of the German Copyright Act were inter alia introduced (see Sect. VI 3 below on this subject);

– Directive 2001/84/EC dated 27.9.2001 regarding the resale right of the author of the original of a work of art.

The directives may be retrieved in full text via the European Union’s Internet portal EUR-Lex: <http://europa.eu.int/eur-lex/lex/en/index.htm>

2.2 *Personal Intellectual Creation*

Only works representing a personal intellectual creation (Section 2 Para. 2 of the German Copyright Act) are subject to copyright protection. That means that a work must show a certain individuality and contain a certain degree of creative achievement. The work must stand out from the mechanical and routine through this level of creativity and individuality (the so-called “level of creativity”, “Schöpfungshöhe”).

Thus, for example, short tunes may represent a sufficiently high creative achievement and as a result be capable of being protected as a musical composition. However, a single chord or a certain sound is not capable of being protected. Even short letters or business letters generally do not show sufficiently individual, creative characteristics in order to enjoy copyright protection as literary works.

The “level of creativity” involves a vague legal concept whose boundaries cannot be clearly determined. Whether a work attains the necessary level of creativity and is thus capable of being protected by copyright is assessed by case law according to the circumstances of the individual case.

Due to several EU directives on copyright, there is a trend to make only moderate demands for the level of creativity of a work. Thus, for example, only quite moderate demands are made for the protectability of software. In accordance with Section 69a Para. 3 of the German Copyright Act (a provision which is attributable to the EU directive for the protection of software) it is sufficient if software is the author’s own intellectual creation. A special level of creativity or individuality of the software is not necessary.

2.3 *Form and Content*

The intellectual content is only protected if it has found expression in a specific form. The concepts and ideas of a protected work are copyright-free. Nevertheless, the content of a work may in some cases enjoy copyright protection, if it is based on an individually creative achievement. For example, the plot of a novel, including the people involved, may be protected by copyright, with the result that the publication of a sequel would represent a copyright infringement.

However, the content of scientific or technical works, e.g. the ideas and concepts behind a scientific article, are not protected by copyright. On the other hand, the article as such, i.e. the concept expressed in a specific form, enjoys copyright protection.

2.4 *Derivative Works*

The copyright protection for adaptations or modifications of existing works (e.g. translations, musical arrangements, abridgments or any other transformations or adaptations) depends on the degree of dependence on the original work.

Minor amendments or adaptations which show no individual characteristics do not give rise to a new work independently capable of being protected.

If an adaptation shows an independent individual character, but specific characteristics of the original are still identifiable, it may enjoy independent copyright protection in accordance with Section 3 of the German Copyright Act. However, the copyright for such derivative works is dependent on the copyright to the original work. Therefore, derivative works may only be published and exploited with the agreement of the author of the original work (Section 23 of the German Copyright Act).

If an author is merely being inspired by an existing work in the creation of a new work, such use of the existing work may be permitted in accordance with Section 24 of the German Copyright Act, if the characteristic features of the new work are stronger than those of the existing work (so-called “free use” of an existing work). In such a case, the new work is not considered a derivative work and enjoys copyright protection independent of the existing work. Therefore, it may be published and exploited without the consent of the author of the employed work.

The transitions between derivative works and free use are fluid and not always clearly determined.

2.5 Formal Requirements and Term of Protection

The copyright protection for a work arises with the creation of the work. There are no formal requirements. A notification or registration at a government agency is also not necessary. Therefore, there is no official verification of the protectability of a work. A court verifies the protectability of the work in question (particularly the level of creativity) only if copyright claims are asserted by legal process.

The copyright expires 70 years after the death of the author (Section 64 of the German Copyright Act). Different terms apply for jointly owned works, cinematographic works and anonymous or pseudonymous works (Sections 65, 66 of the German Copyright Act).

3 The Author

3.1 Natural Person

The author of a work is its creator and therefore always a natural person (Section 7 of the German Copyright Act). Even minors can be authors in accordance with the German Copyright Act, as the legal capacity to contracts is irrelevant in that respect.

If a work has been created by a group of persons, they are joint authors (Section 8 of the German Copyright Act), the copyright to the work is owned by them jointly. In order to avoid disputes with the later economic exploitation of such

jointly owned works, it is recommended to make appropriate contractual provisions even before the creation of the work begins.

3.2 Authors in Employment Relationships

Even if a work is created by an employee in fulfilment of his employment relationship, the sole author is the employee and not the employer. In that respect, the German copyright differs from the Anglo-American copyright where the employer is regarded as the author of works which were created within the framework of an employment relationship.

If an employer wants to exploit works created by employees, corresponding rights of utilisation (licences) must be granted to him. The employee is generally obligated to grant such rights on the basis of the employment contract. The obligation for the granting of licenses may arise explicitly or tacitly from the employment contract. In case explicit contractual provisions are missing, the scope of the licenses granted to the employer results from the content and purpose of the employment contract or of the employment relationship (cf. Section 43 of the German Copyright Act). If it is foreseeable that copyrighted works will be created within the framework of an employment relationship, the employment contract should therefore contain clear and explicit provisions in respect of licenses for the avoidance of later disputes.

Special provisions apply for software. The employer is entitled by law to the exclusive exercising of all economic rights to the software, provided that a different agreement was not explicitly concluded (Section 69b of the German Copyright Act).

4 Exclusive Rights in Copyrighted Works

The copyright grants the author exclusive rights in his work which necessarily include so called “moral rights” to the work as well as all economic rights.

4.1 Moral Rights

The moral rights protect the author in his intellectual and personal dealings with the work (Section 11 of the German Copyright Act). Accordingly, the author has the (initial) right of publication in accordance with Section 12 of the German Copyright Act, i.e. he may determine whether and how his work is published. Furthermore, the author has the right to be identified as the author of his work (acknowledgement of authorship) and in particular to the affixing of an author’s designation to the work (Section 13 of the German Copyright Act). Even authors who have created

works within the framework of an employment relationship have the right to be identified as the author of such works. However, the right may only be exercised within the limits customary to the trade, depending on the type of the work. For example, the naming of the author is customary (and possible) with books or articles, whereas the author of a screenplay may only request to be named in the film credits, but not to be named on posters or in advertisements.

The author may ban distortions or other detractions to his work (Section 14 of the German Copyright Act). For example, distortions, abbreviations or changes are considered to be detractions. Thus, the author of a picture or of a sculpture may prevent a buyer from changing his work, for example, by painting over individual sections. However, the author cannot prohibit the complete destruction of a work according to Section 14 of the German Copyright Act.

In accordance with Section 42 of the German Copyright Act, the author has a right of revocation by reason of changed conviction, with which he may withdraw granted rights of utilisation (licences) from third parties. Such a case may exist, for instance, if the opinion represented in a scientific treatise is overtaken by new findings or if an author has changed his political or aesthetic convictions. The author may not waive the right of revocation or contractually exclude it (Section 42 Para. 2 of the German Copyright Act). However, the exercising of the right of revocation requires payment of an appropriate compensation (Section 42 Para. 3 of the German Copyright Act).

Contractual provisions regarding the moral rights of the author shall only be possible in narrow limits and in some cases are expressly prohibited by statute (cf. Section 42 Para. 2 of the German Copyright Act). The core of the author's moral rights is not subject to contractual provisions.

4.2 *Exploitation Rights*

Exploitation rights grant exclusive rights to the author for the economic exploitation of the work. The author has the sole right to exploit his work under exploitation rights and to exclude third parties from the exploitation of the work. He should be able to determine whether, when and how his work will be used to secure the economic exploitation of his work. Economic exploitation is achieved by granting rights of utilisation or licences to third parties for remuneration (see Sect. 5 below on this subject).

Some exploitation rights are listed in Section 15 of the German Copyright Act by way of example and provided in more detail in Sections 16–22 of the German Copyright Act. The list of exploitation rights in Sections 15–22 of the German Copyright Act is not definitive. Types of usage that may arise in the future are also reserved to the author. New types of usage usually arise due to technological advance. Accordingly, the new exploitation opportunities opened up by the Internet were unknown 20 years ago.

Section 15 of the German Copyright Act differentiates between the exploitation of a work in the tangible and intangible form. In accordance with Section 15 Para.

1 of the German Copyright Act, the author has the exclusive right to exploit his work in the tangible form. This includes inter alia the following exploitation rights:

1. The right of reproduction (Section 16 of the German Copyright Act) is the right to copy the work by temporarily or permanently producing duplicated items of a work, regardless of the means and form of the reproduction. Even copies on disks or hard drives or in the memory of a computer are reproductions for the purposes of law.
2. The right of distribution, including rental, lease and lending (Section 17 of the German Copyright Act).

The distribution right is the right to offer or to market the original or copies of a work to the general public. The distribution right to a copy of the work exhausts with the first sale of that copy in the territory of the EU by the author or copyright holder or with his consent, in accordance with Section 17 Para. 2 of the German Copyright Act. Thus, only the right to the first distribution belongs to the author. The rental and lending right does not exhaust and remains reserved to the author even after the first sale.

3. The right of exhibition (Section 18 of the German Copyright Act).

In accordance with Section 15 Para. 2, the author has the exclusive right to perform his work publicly in intangible form. Non-public performances (e.g. a private listening to a CD) are not subject to the author's exploitation rights. Performances are public if they are intended for a multitude of people which are not connected by personal relationships between each other or with the reproducer. This includes inter alia:

4. The right of recitation and performance (Section 19 of the German Copyright Act).
5. The right of making available a work to the public (Section 19a of the German Copyright Act). This includes the right to make a work accessible to members of the general public in networks such as the Internet (e.g. through provision on a website).
6. The broadcasting right (Section 20 of the German Copyright Act).
7. The right of performance by means of picture or sound carriers (Section 21 of the German Copyright Act), e.g. the playing of music in discos or restaurants.
8. The right of performance of radio broadcasts (Section 22 of the German Copyright Act), e.g. through the installation of televisions in bars or restaurants.

5 Copyright Contract Law

The copyright contract law is only regulated in the German Copyright Act in a fragmentary manner. The German Publishing Act [Verlagsgesetz] provides some special provisions for the publishing contract. Otherwise, the contract terms, except for a few statutory requirements of the German Copyright Act, are essentially relinquished to the parties to the contract. Nevertheless, general provisions regarding contracts (e.g. regarding unfair terms in consumer contracts) may be applicable.

5.1 Rights of Utilisation and Licences

The copyright and the individual exploitation rights are not assignable. The copyright may merely be bequeathed (Section 28 of the German Copyright Act). However, the author may contractually grant rights of utilisation to his work (licences) to third parties.

The German copyright differentiates between exploitation rights and rights of utilisation. Exploitation rights are the non-transferable, proprietary component of copyright. Rights of utilisation are exploitation entitlements that are granted to a third party. The granting of rights of utilisation largely corresponds to the licence in Anglo-American law.

5.2 Granting of Rights of Utilisation

Rights of utilisation may be granted separately or overall, non-exclusively or exclusively, with restrictions or without restrictions (Section 31 of the German Copyright Act).

If an exclusive right of utilisation is granted to the licensee, only the licensee may utilise the work in the designated way. Even the author or licensor is excluded from the utilisation. In the case of a non-exclusive right of utilisation, the licensee may in fact utilize the work in the designated way, but the author or licensor may also grant other equal rights of utilisation and may also utilise the work himself in the designated way.

Rights of utilisation may be granted with geographical, temporal and content restrictions. Thus, for example, the right of performance for a stage play may be geographically restricted to several theatres. Rights of utilisation may be granted for a specific period or for an indefinite period. As regards content, rights of utilisation may be restricted, for example, to specific distributions (hardback, paperback) or to certain media types (CD, DVD, video, record).

5.3 Limited Transfer of Rights

Should the types of usage granted be not explicitly individually indicated in a contract (e.g. with open-ended wordings such as “granting of rights of utilisation for use in an advertising brochure”), the scope of such license will be determined according to the purpose of the contract (Section 31 Para. 5 of the German Copyright Act).

In the process, a doctrine regarding the limited transfer of rights (“Zweckübertragungslhre”) applies, according to which in case of doubt the transfer of rights is limited to the scope required by the purpose of the contract. Thus, license agreements are interpreted by the courts in an author-friendly way: the copyright has the tendency to remain with the author as far as possible.

If no specific provision is made, the party to the contract will only be granted rights to the extent necessary in accordance with the purpose of the contract. Therefore, explicit contractual provisions are strongly recommended. A general wording, such as the granting “of all rights”, does not even entail all rights, but merely those that are actually necessary with regard to the purpose of the contract. Therefore, the purpose pursued with the contract should be phrased as clearly as possible. The required rights of utilisation and their extent should be listed in as much length and detail as possible in the contract. In case of doubt, only the transfer of explicitly identified rights of utilisation is agreed.

As of 1 January 2008 rights of utilisation can even be granted for unknown types of usage (Section 31a of the German Copyright Act). However, pursuant to Section 32c of the German Copyright Act the author is entitled to an additional appropriate consideration if the licensee wants to use the work for types of usage not known at the time of conclusion of the contract.

5.4 Appropriate Consideration

In accordance with Section 32 of the German Copyright Act, the author has an entitlement to an appropriate consideration for the granting of rights of utilisation. If the contractually agreed consideration is not appropriate, he may request a corresponding contract amendment. Whatever is customarily and actually paid in business at the time of the conclusion of the contract, taking into account all the circumstances, is deemed to be appropriate in accordance with Section 32 Para. 2 of the German Copyright Act. In case of doubt, a court will rule to its clear satisfaction on what consideration is appropriate in an individual case, in accordance with Section 287 Para. 2 of the German Code of Civil Procedure with evaluation of all circumstances.

If, after conclusion of the contract, a striking disparity arises between the agreed consideration and the incomes and advantages from the exploitation of the work, the author may request a contract amendment in accordance with Section 32a of the German Copyright Act, which grants him an appropriate participation in the exploitation of his work.

6 Limitations

The copyright includes various limitations for the benefit of individual users, the cultural economy and the general public in Section 44a et seq. of the German Copyright Act. However, the German copyright recognizes no all-purpose limitation such as the “fair use” principle of the American copyright.

Limitations exist, for example, for the benefit of judicial proceedings and public security, disabled people, education, freedom of the press and information and academic freedom.

That is why quotations from works are allowed to a certain extent in accordance with Section 51 of the German Copyright Act, without requiring a corresponding license by the author. In accordance with Section 51 No. 1 of the German Copyright Act, it is permitted to include third-party works for the explanation of the content in an independent academic work (so-called long quotation). Passages of a work, i.e. small sections, may also be included in other (literary) works for other than academic purposes in accordance with Section 51 No. 2 of the German Copyright Act (so-called short quotation).

The rights of the author to his works and his economic exploitation opportunities, are restricted by such limitations. The law therefore provides a financial compensation for the author in some cases in the form of consideration entitlements. These consideration entitlements are generally asserted by collecting organisations (full details on this subject in Sect. 8 below).

For example, in accordance with Section 53 Para. 1 of the German Copyright Act, copies of a work may be made for personal use, in so far as they neither serve profit-making purposes nor are produced by a clearly unlawfully manufactured template (“private copy”). Therefore the law provides for an indirect remuneration system for these permitted private copies in the form of copyright fees. In accordance with Section 54 Para. 1 of the German Copyright Act, the authors have an entitlement to appropriate consideration for private copies. However, the entitlement is not directed against the private end users, but against the manufacturers of copying machines (e.g. video recorders, copiers, fax machines, scanners) and the manufacturers of blank media (video cassettes, blank CDs). These consideration entitlements are administered by collecting organizations (see Sect. 8 below on this subject) in accordance with Section 54h of the German Copyright Act. That means that the manufacturers pay the equipment and blank media fees to the collecting societies and they in turn distribute the fees to the authors.

7 Other Provisions

In addition to the actual copyright for works of science and art, the German Copyright Act contains provisions regarding related rights (the so-called neighbouring rights) and assets such as software and databases. Their protection follows the copyright protection in major areas, with the result that these matters were regulated in conjunction with the copyright.

7.1 Related Rights

Related rights regulate the protection of scientific or artistic achievements, which do not involve the creation of copyright works. This relates, for example, to the

performances of artists such as musicians or actors. Furthermore, investments by companies which are engaged in the area of the exploitation of cultural works are protected by related rights (e.g. concert organizers, producers of sound recordings or broadcasting companies).

Related rights are regulated in Section 70 et seq. of the German Copyright Act. By way of example, the provisions for the protection of performing artists, academic editions and photographs are described below.

7.1.1 Performing Artists

Performing artists, i.e. musicians, actors, conductors, achieve no separate intellectual creation rights, but perform a work already created by an author. Nevertheless, they provide an artistic performance meriting protection.

Therefore, Section 73 et seq. of the German Copyright Act grants a specific right to the performing artists for their presentations. Thus, the performing artist has the exclusive right to record his performance on picture or sound carriers and to reproduce and distribute (Section 77 of the German Copyright Act) or publicly perform (Section 78 of the German Copyright Act) such recordings. Section 74 et seq. of the German Copyright Act grant specific moral rights to the performance, for example, the right to be recognized as the performing artist (Section 74 of the German Copyright Act) and a deformation protection (Section 75 of the German Copyright Act). The exploitation rights to picture and sound carriers expire 50 years after publication of the picture or sound carrier (Section 82 of the German Copyright Act). The moral rights expire, as a rule, with the death of the performing artist in accordance with Section 76 of the German Copyright Act.

7.1.2 Academic Editions

Section 70 of the German Copyright Act grants a right for academic editions of copyright-free works or texts. However, the edition must be the outcome of academically screened work and differ significantly from the hitherto known editions. The protection for academic editions expires 25 years after publication.

7.1.3 Photographs

Photographs may be protected by copyright as photographic works or by a related right as photographs. The law contains a content-related differentiation in this respect.

Photographic works need to have copyright work quality, i.e. they must have a personal intellectual creation with a certain degree of creative achievement (see above Sect. 2.2). Photographic works are protected as copyright works in accordance with the provisions of copyright described above.

Photographs not reaching the necessary level of individuality and creativity for copyright protection, such as everyday holiday photographs without artistic content or snapshots, are protected by a related right in accordance with Section 72 of the German Copyright Act. The protection period for such photographs expires 50 years after the photograph was published or produced (Section 72 Para. 3 of the German Copyright Act).

7.2 *Databases and Software*

The legal protection for databases is regulated in Section 4, 87a et seq. of the German Copyright Act. The law differentiates here – similar to the protection for photographs (Sect. 1.3 above) – between database works and databases.

Database works enjoy full copyright protection in accordance with Section 4 of the German Copyright Act. This requires a systematic or methodical structure of the database, representing a personal intellectual creation beyond the obvious or purely mechanical. The selection and structuring of the content must show a certain originality. However, the qualification of a database as a database work does not depend on the possibility of protection or level of creativity of the content. Only the structure of a database and not its content is relevant in differentiating between database works and databases.

All other databases enjoy protection in accordance with Section 87a et seq. of the German Copyright Act. A specific intellectual achievement in respect of the configuration or structure of the database is not necessary for the protection according to Section 87a et seq. of the German Copyright Act. The objective of these provisions is the protection of the investment in the obtaining, collection, verification, processing and presentation of the database content.

In accordance with Section 87b of the German Copyright Act, the database producer has the exclusive right to copy and distribute the database in total or a significant part by type or size. The systematic and repeated copying or distribution of insignificant parts is forbidden, provided that such actions are not a normal exploitation of the database. In accordance with Section 87d of the German Copyright Act, the rights of the database producer expire 15 years after publication of the database.

The right to the database and the rights to the database content are different rights. The rights to database and content may be owned by different copyright holders. If content is protected by copyright, it may be necessary to acquire licenses for the inclusion into and retrieval from the database. For example, each article in a database containing magazine articles is protected by copyright and may have different owners or copyright holders.

Sections 69a et seq. of the German Copyright Act contains special provisions regarding the protection of software. These are explained in more detail in the section “Computer Law”.

7.3 *Protection of Technological Measures*

Sections 95a et seq. of the German Copyright Act include provisions regarding the protection of technological protection measures, which are comparable with the regulations of the American Digital Millennium Copyright Act. Effective technological measures for the protection of works protected by copyright – e.g. copy protection devices – may not be circumvented without the consent of the right-holder. The manufacture, import and distribution of devices that are used for the circumvention of such protection measures are also prohibited.

8 **Collecting Societies**

It is difficult for authors and rightholders to effectively control certain forms of mass exploitations of protected works. For example, the composer has a right to public performances of his work in accordance with Section 21 of the German Copyright Act, but can hardly himself control the performance of his music in concerts, public houses or discos. Conversely, it would be too expensive for the operator of a disco to obtain a separate licence from the respective rightholder for each song played.

Therefore, certain rights are collectively administered for the authors by the so-called collecting societies. This includes the collection and distribution of the above-mentioned equipment and blank media fees for private copies and other consideration entitlements in respect of copyright limitations (see above Sect. 6). The rights and obligations of collecting societies are regulated in the German Copyright Administration Act [Urheberrechtswahrnehmungsgesetz].

There are currently 11 collecting societies in Germany. The most important are:

GEMA: administers the rights of composers, songwriters and music publishers.

VG Wort: administers the rights to literary works in the area of literature and science.

VG Bild-Kunst: administers rights of fine artists, designers, photographers, picture agencies and film authors.

GVL: administers the related rights of performing artists and producers of sound recordings.

The collecting societies have an effective monopoly in their respective field of activity. Therefore, they are obligated by statute to administer the rights and entitlements of the authors pertaining to their field of activity at appropriate terms and conditions (administration obligation). They are also obligated to conclude an appropriate license agreement at adequate terms and conditions with anyone who wishes to utilise the rights administered by them (obligation to contract). The German Patent and Trademark Office supervises the activity of the collecting societies.

9 Legal Protection

9.1 Entitlements Under Civil Law

In the event of a culpable infringement of copyright proprietary rights, the aggrieved party shall be entitled to a claim for compensation in accordance with Section 97 of the German Copyright Act. The aggrieved party has the choice between three alternatives, according to which he can calculate the claim:

Firstly, he may request his actual losses including the lost profit.

However, he may also request an appropriate consideration – generally the customary licence fee – for the unauthorised utilisation of the work. This applies even if no licence would have been granted to the infringing party in the actual case. The level of the appropriate consideration is assessed in accordance with objective benchmarks, i.e. in accordance with what a reasonable licensor would have required and a reasonable licensee would have paid.

The aggrieved party may also request the handing over of the net profit, which the infringing party has obtained arising from his infringement. In addition, the aggrieved party may request information and the rendering of an account regarding this profit.

The aggrieved party may assert demands without fault for injunctive relief for infringements of a right and encroachments. There is an entitlement to the destruction of unlawfully manufactured copies and to the destruction or surrender of the devices employed for such copying, provided that they are the property of the infringing party (Sections 98, 99 of the German Copyright Act).

If the infringements of a right have been committed in a company by an employee, the aggrieved party shall be entitled to claims for injunctive relief against the owner of the company as well (Section 100 of the German Copyright Act). Unlawfully manufactured copies may be neither distributed nor publicly performed in accordance with Section 96 of the German Copyright Act.

9.2 Protection Under Criminal Law

Apart from claims under civil law, the copyright also grants protection under criminal law. In accordance with Section 106 of the German Copyright Act, the illegal duplication, distribution or public performance of a work is punishable. Section 108 of the German Copyright Act makes the infringement of certain related rights a punishable offence. In accordance with Section 107 of the German Copyright Act, the unlawful claiming of an author's designations is punishable. The range of punishments is a custodial sentence of up to 5 years or a fine in the case of commercial trading (Section 108a of the German Copyright Act), otherwise a custodial sentence of up to 3 years or a fine.

10 Additional Information

10.1 Laws

German Copyright Act: <http://bundesrecht.juris.de/bundesrecht/urhg/>

EU directives are to be found under: <http://europa.eu.int/eur-lex/lex/en/index.htm>

10.2 Institutions

VG Wort: <http://www.vgwort.de/>

GEMA: <http://www.gema.de/>

VG Bild-Kunst: <http://www.bildkunst.de/>

GVL: <http://www.gvl.de/>

German Patent and Trademark Office: <http://www.dpma.de/>

Review of German Private Insurance Law

T. Steffens

1 The Concept of Insurance

The term insurance describes the basic principle of collective risk assumption (insurance principle): A large number of people pay an amount of money (insurance premium) to an insurance company in order to receive compensation for damages arising from an event covered by insurance. Therefore insurance means the economic provision against risks according to the principle of probability against the payment of premiums.

Insurance is organized either according to the so-called association principle as mutual insurance or according to the speculation principle as income insurance. The mutual insurance companies of today usually require fixed premiums according to the speculation principle as well.

1.1 *Insurable Risks*

Insurable risks are manifold. However, the variety can be reduced to a few classes of risk which cannot be exactly distinguished from each other in all cases:

1.1.1 **Biometric Risks**

Biometric risks are individual risks with regard to someone's life and livelihood, such as occupational disability, the need of permanent care, senility, and untimely death. These risks are covered by life insurance products.

1.1.2 **Cost Risks**

Cost risks such as court fees or costs of an illness are covered, e.g. by legal expenses insurance and health insurance.

1.1.3 Risks of Damage and Loss

Risks of damage and loss due to events such as fire, accident, and theft are covered by various kinds of insurance against loss. Examples are residential buildings insurance, accident insurance, or homeowners insurance.

1.1.4 Third-Party Risks

The various forms of personal liability insurance cover third-party risks.

1.2 Principles of Coverage

For the coverage of contingent rights, especially with regard to personal insurance, two basic principles of coverage are important:

1.2.1 Funding Principle

The funding principle is applied in the private insurance industry.

1.2.2 Sharing of Costs Principle

The sharing of costs principle is applied primarily for compulsory insurance. In the true sense of the word, compulsory insurance is not insurance but a transfer scheme.

The difference between the two principles of coverage can be demonstrated with a comparison of statutory retirement insurance and a private pension scheme. Irrespective of the principle of coverage, both schemes are intended for the coverage of retirement – and partly of the disability risk as well. While capital is accrued from the contributions to the private pension scheme based on which a pension amount determined by actuarial calculation is paid, the monthly contributions paid in to the statutory retirement insurance are immediately paid out according to the principle of sharing costs and expenses. Future retirees in Germany depend on the scenario that future premium payers will finance the retirement pensions with their contributions. In view of an increasing number of retirees and a decreasing number of contributors, this is a highly unstable scheme.

1.3 The System of German Insurance Law

The legal system of the Federal Republic of Germany divides insurance law into the increasingly comprehensive social insurance law and private insurance law.

The branches of social insurance law are practically becoming more and more extensive. However, they can be regarded as insurance only to a limited degree as they are publicly organized compulsory insurance schemes funded on the basis of cost sharing. This review does not concern itself with social insurance law for this reason.

Private insurance law includes insurance company law, insurance supervision law, and insurance contract law. The fields of insurance company law and insurance supervision law contain private law and public law provisions which concern the insurance companies directly. This sector of general and special corporate law is regulated for instance in the Stock Corporation Act (“Aktiengesetz” – AktG), the Civil Code (“Bürgerliches Gesetzbuch” – BGB), the Commercial Code (“Handelsgesetzbuch” – HGB), the Insurance Supervision Act (“Versicherungsaufsichtsgesetz” – VAG), and in accounting regulations, statutory regulations, and administrative acts.

As special field of the law of obligations, insurance contract law concerns the legal relationships between insurance company and insurance holder. It represents special private law responding to the characteristics of the contract of insurance.

1.4 Excursus: D&O Insurance as a Topical Example of the Significance of Insurance Law

1.4.1 General Notes

At present the focus is on directors and officers liability insurance (D&O insurance), gaining in importance to the economy increasingly.

Decision-makers in executive positions assume a particularly responsible assignment in their entrepreneurial planning and action. Almost all decisions to be made, under high time pressure, have far-reaching consequences. Groundbreaking decisions often carry risks as not all determining factors are calculable in advance. Wrong decisions can result in the company’s pecuniary loss amounting to millions. Top managers are personally liable with their private assets for the property damages of the company and third parties. A liability case can therefore put a manager’s professional and private existence at risk.

1.4.2 Beneficiaries of Insurance

D&O insurance provides not only security against claims by third parties but protection of the beneficiary’s existence as well. D&O insurance was initially devised in the United States. In Germany, “directors” would mean the members of the supervisory board or advisory board (board of directors in the U.S.), “officers” include a company’s managing directors and members of the management board. Persons holding those positions are subject to a large number of potential claims.

They can be held liable for instance in accordance with the Stock Corporation Act or the Private Limited Companies Act (“GmbH-Gesetz”). Accordingly, they are liable, e.g. for infringements of statutory provisions and the breach of duties resulting from their positions of trust.

1.4.3 Scope of Insurance

D&O insurance covers the circle of top managers against the risk of property damages arising from a dereliction of duty within the context of the insured occupation. Insurance cover is provided in the case of negligence for liability claims of third parties as well as for the company’s recourse, e.g. in cases of organizational fault or faulty control and supervision. The circle of potential claimants is wide and includes the manager’s own company, stockholders, creditors, employees, public authorities, and other third parties such as banks. Besides manifold disclaimers listed in the separate insurers’ general conditions of insurance, insurance coverage does basically not protect against liability claims founded on the deliberate perpetration of damage, or damage caused by deliberate non-compliance with the law, regulations, a resolution, an authorization or instruction, or another kind of deliberate neglect of duty (so-called *deliberateness exemption clause* – “*Wissentlichkeitsausschluss*”). A deliberate breach of duty is committed by someone who is aware of both the duty and its neglect at the time of the act. Therefore a deliberate breach of duty with the consequence of an exemption from the insurer’s liability is assumed only if the insurer manages to represent and proof if necessary that the manager had a sense of duty in the first place and was aware of the breach of duty as well.

In the case of D&O insurance, the insurance contract is concluded as a so-called corporate insurance policy, i.e. not between the board members and the insurer but rather between insurer and company. Therefore the companies are insurance holders whereas the members of the board are merely insured persons. The board members are insured as a collective, implying that the insurance coverage does not refer to certain individuals but to all individuals who are members of the insured company boards in the course of the insurance period.

If it comes to legal proceedings, the burden of proof is not on the suitor but the manager himself. Within the framework of insurance coverage, unfounded claims are averted; justified claims are indemnified and handled confidentially. Liability claims against directors and officers are covered with regard to the internal relationship as well as in relation to third parties.

A so-called retroactive insurance may also be included in the insurance conditions, covering previously unknown neglects of duty committed prior to the commencement of the contract. A period of secondary liability can also be provided for, referring to insured events caused by neglects of duty committed during the term of insurance or the term of retroactive insurance.

Because the D&O insurance is of crucial importance not only to the protection of the assets held by the insured managers but to the protection of the company’s

financial interests, it has meanwhile become a household item to the managers of large corporations and their advisors.

D&O insurance also has major significance for medium-sized companies where the managers' third-party risks are not lower than in large-scale enterprises. Medium-sized companies have come to face intensified challenges of liability as well. According to the Securities Trading Act ("Wertpapierhandelsgesetz") for instance, the managing director is directly liable. If he makes a wrong decision, be it that justified claims are not filed in time, subsidies are not requested, or acquisitions turn out to be bad investments, the company will have recourse against the manager who might be confronted with financial ruin unless he has insurance against that risk. If there is no corresponding insurance, the company's entrepreneurial potential will also be in danger, because an absence of insurance indicates inadequate risk management and impairs creditworthiness which might be a decisive factor towards eventual insolvency in a state of economic crisis. For this reason it has become inevitable for every manager to give close attention to D&O insurance in the company's interest, beyond his own interest in personal precaution.

It must be taken note of the fact that the individual insurers' terms and conditions of insurance vary in detail, just as the conditions for acceptance are different among the insurance companies. Differences particularly concern disclaimers. Before a D&O insurance policy is taken out, the various coverage concepts available on the market should be scrutinized and, if necessary, negotiations should be entered into with the favored provider with the objective to waive certain unfavorable insurance conditions by private agreement. The amount of the premium to be paid for D&O insurance is also negotiable. Therefore knowledge of the legal basics of D&O insurance as well as private insurance law, valid for D&O insurance, is important for negotiations on this terrain.

2 The Contract of Insurance

2.1 Definition

The insurance contract is a bilateral contractual agreement with the nature of a continuing obligation, added by a membership relation in the case of a mutual insurance association ("Gegenseitigkeitsverein" – Sections 15 et seq. VAG). The contract may also be entered into for the benefit of a third party (the insured person, Sections 74 et seq. VVG; the beneficiary in case of life insurance, Section 166 VVG). Its private law nature does not change if the contract is concluded on the basis of an obligation under public law (e.g. compulsory third-party motor insurance).

The Insurance Contract Act ("Versicherungsvertragsgesetz" – VVG) does not provide a legal definition of the term insurance contract, and neither does the remaining body of German law. The term is subject to law book debate. Legal practice defines an insurance contract to the effect that one party commits itself as

insurer against payment to make an asset-forming contribution to the other party – the insurance holder – in the occurrence of an uncertain event, within a framework which spreads the insurer’s assumed economic risk to a large number of people facing the same kind of risk and bases the risk assumption on a calculation applying the law of large numbers.

In addition, contractual criteria have been developed and find use in the courts of law. If those criteria are met, the Insurance Contract Act is applied (please refer to a detailed discussion of the VVG in Sect. 2.2).

The following features of an insurance contract are often named by insurance scientists as typical:

Accordingly, an insurance contract is the non-gratuitous, legally binding, independent promise of a benefit in case an event occurs of which it is yet uncertain if or when it will occur (insured event), involving a spreading of risks in accordance with the law of large numbers.

Since the reform of the Insurance Contract Act effective January 1, 2008, the purview of the act has been described as follows:

“Through the insurance contract, the insurer enters into the commitment to cover a certain risk of the insurance holder or a third party with a benefit the insurer has to provide upon occurrence of the event insured as agreed upon. The insurance holder is obliged to pay the agreed premium to the insurer.”

2.2 Sources of Law

Because of the increasing economic significance of insurance and the numerous particularities of insurance law, the Insurance Contract Act (“Versicherungsvertragsgesetz” – VVG) came into force in 1908. On the occasion of its 100th anniversary, the act underwent radical revision. New provisions have been in effect since January 1, 2008, giving support particularly to the rights of the insurance holders (for a discussion of the amendments see Sect. 4).

As a special statute of insurance law, the VVG takes precedence over the provisions of the Civil Code (BGB), of which only the general provisions, e.g. with regard to a contract’s general terms and conditions (“Allgemeine Geschäftsbedingungen” – AGB), and the specific use of language for the interpretation of the VVG are decisive. In addition to the VVG and the BGB, the Insurance Supervision Act (VAG) and the Commercial Code (HGB) exert indirect influence on the insurance contract. By provisions of these acts, legal and economic boundaries are set for the insurance companies’ decisions on the preparations of contracts.

The VVG does not apply to the branches of social insurance, marine insurance, and reinsurance.

Apart from statutory provisions, the conditions of the specific insurance contract (conditions of insurance) are of central importance. They are documented in the deed of covenant (in insurance law the legal term is insurance policy). Contractual

stipulations contained in the insurance proposal may also be of significance, especially with regard to pre-contractual obligations. Contractual provisions can be either individual agreements or general terms and conditions (AGB).

Among other stipulations, the AGB of the insurance contract are generally referred to as general conditions of insurance (“Allgemeine Versicherungsbedingungen” – AVB), regardless of their location in the deed of covenant. They are usually a compilation of the contract’s AGB. Mostly they are reproduced as a separate section at the end of the insurance policy. They may also come in the shape of contractual stipulations which constitute the basis of a variety of insurance contracts irrespective of the individual differences of the specific risks.

In addition to the individual agreements of the insurance contract, the special conditions of insurance (“Besondere Versicherungsbedingungen” – BV) include, among other things, a collection of parts of the contract’s AGB, mostly reproduced as a separate section at the end of the insurance policy, insofar as they regard special or optional risks or subject matters covered by contract, e.g. for supplementary insurance. The BV apply only to the specific insurance contract and take precedence over the AVB.

All AGB or AVB are subject to the consumer protection legislation of the Civil Code (Sections 305 et seq. BGB). Accordingly, ambiguities are to the insurer’s expense, surprising or discriminatory clauses are null and void. To some extent contractual stipulations quote the statutory provisions, partly they deviate or substantiate them. They shall determine the entirety of both parties’ contractual rights arising from the insurance contract, insofar as those rights do not arise directly from the statutory law.

Ever since the abolition of the regulation of the German insurance industry and the corresponding license requirement for contractual provisions, effective until 1994, the individual insurance companies have been in stiff competition with regard to the definition of insurance coverage as it results in part from the contractual stipulations. This makes a comparison of contractual provisions essential prior to contracting new insurance.

The freedom of contract basically applies to insurance law as part of private law. Therefore the initial decision of insurance holder and insurer if a contract will be concluded and, if so, what its contents shall be, is an autonomous decision. However, this basic freedom to contract is restricted by insurance contract in favor of the insurance holder. This is achieved by the legal method according to which the legislator implements in part compulsory provisions, in part “half-compulsory” ones. Compulsory provisions obviously can be deviated from not at all, half-compulsory ones only for the benefit of the insurance holder.

Which interests for the protection against which risks the insurer is willing to cover for the benefit of the insurance holder is agreed upon at the time of the contract’s conclusion and included in the insurance policy. Usually the general conditions of insurance describe in detail what belongs in the matter of the insured object’s risks and what is meant to be expressly uncovered by insurance. Thus the contracts’ contents are typified.

2.3 *Parties Involved in the Insurance Contract*

As contracting parties of an insurance contract, the insurer on one side faces the insurance holder on the other side. Insurance holders can be natural persons as well as distinct legal entities. On both sides of the contract several parties may be involved. If a married couple is concerned, for instance, both partners can act as insurance holders. Just as well, several insurers (a consortium) can be engaged in a single insurance contract. Insurers usually act as (incorporated) insurance companies. They can also be organized as mutual insurance associations (“*Versicherungsverein auf Gegenseitigkeit*” – VVaG) or insurance institutions under public law. Foreign insurers headquartered in member states of the European Union, the European Economic Area, and Switzerland are licensed for the single European market under the same conditions as applies for the country of their head office. Insurers based in other countries must establish a branch office in Germany before they may obtain a domestic license.

As far as personal insurance is concerned, in addition to the insurance holder there are one or several insured persons taken into account for the insuree’s risk. With other kinds of insurance, the insurance contract takes the insured object or a proprietary interest into account, and the person whose interest is relevant is always the insurance holder.

The beneficiaries taken into account for the insuree’s risk (e.g. in the case of life insurance) do not belong to the involved parties in the narrower sense. However, they do have rights to information and dispositive rights with regard to the insurance contract, as is the case with occupational pension schemes for example.

Yet it is categorically the insurance holder who is entitled to claim the benefit, even if the insurance contract often names another person as beneficiary, as in the case of life insurance. The appointment of beneficiary is basically revocable and therefore does not constitute a claim of the beneficiary; his claim comes into existence only with the due date of benefit payment. A different case is the irrevocable determination of the appointment of beneficiary in the insurance contract. The beneficiary is then entitled to certain proprietary rights even prior to the due date, depending on the conditions under which the benefit becomes due.

In insurance against loss or damage third parties are often involved in the insurance contract, be it as insured person in the insurance for another person’s account or on the basis of an otherwise close association with the insuree’s interest.

The insurance “intermediary” who arranges the insurance contract between the contracting parties either as insurance agent or broker is regarded as indirectly involved, too.

The insurance holder can either act by himself at the time of reaching agreement and later on or have himself represented. His agents may be legal or authorized representatives. The general provisions of the Civil Code are basically applicable to the law of representation. If an insurance holder is a merchant, the respective provisions of the Commercial Code are applied in addition.

Within the context of liability insurance, the injured party is always directly involved in the insurance contract. He is protected by the provisions of the VVG against the insurance holder’s detrimental injunctions with regard to the claim for

compensation. However, the injured party basically does not hold a claim against the insurer; he must file an action against the damaging party, i.e. the insurance holder. One exception is provided for in the Compulsory Insurance Act (“Pflichtversicherungsgesetz”), in the shape of a direct claim against the insurer of third-party motor insurance.

2.4 Legal Obligations and Duties of the Parties Involved

2.4.1 Obligations and Duties of the Insurance Holder

The insurance holder has the suable obligation to pay the insurance premium to the insurer.

The insurance holder can also be subject to various duties. These duties differ considerably with respect to the kind of insurance. They may commit the insurance holder to take appropriate action for the prevention of subsequent damage after the occurrence of the event insured. They may further provide that the insurer be notified of the occurrence of the event insured within a certain period of time. Those duties are not suable; however, if they are violated culpably by the insurance holder, this may have as a result that the insurer is no longer, or only partially, obliged to provide the insurance benefits.

2.4.2 Obligations and Duties of the Insurer

The primary contractual obligation of the insurer is the so-called risk assumption, i.e. to provide the agreed benefit in the occurrence of the event insured. There is only one duty for the insurer to fulfill: As the insurance contract represents a continuing obligation, both contracting parties – the insurer in particular – owe each other a continuous effort towards the performance of the contract. The insurer is particularly committed on the basis of the insurance contract to observe the supervisory regulations devised to make sure the contracts will be performed continuously. Within the context of breach of pre-contractual notification duties, the insurer is obliged to examine the documents supplied and to make inquiries if necessary, because if he fails to do so, he cannot refer to the insurance holder’s duty to make the necessary statements in court.

2.5 The Term of the Insurance Contract

2.5.1 Formal Period of Insurance

The cover of insurance usually refers to the occurrence of future events insured. Insurance contracts are generally entered into for a limited period of time. The period over which the contract of insurance extends is called period of insurance or risk

assumption period. The precise definition of inception date and contract termination is an essential agreement of the insurance contract. As far as benefits are paid in the form of pensions, the contract also determines the benefit period for current premiums, the period for premium payment, and the respective due dates of pension or premium payments, especially if payments are to be provided annually, semi-annually, by the quarter, or by the month.

The contract of insurance itself, as an agreement on mutual rights and obligations, has no distinct “period of validity”. It becomes effective at the time it is concluded by the contracting parties in accordance with the provisions of the Civil Code, regardless of the policy’s inception date for instance. The contract “runs out” at the time all rights and obligations under contract have ultimately been fulfilled or have expired for other reasons.

At the beginning of the contract the insurance holders are granted special rights of rescission or revocation. Rights of cancellation are regulated for both parties by statutory provision in the following cases: the insurance holder’s default of premium payment, the insurer’s unjustified refusal to perform, and the benefit case. In private health insurance, the insurer waives the exceptional right of cancellation in the benefit case.

The insurance holder’s rights of cancellation are provided according to the completion of certain periods, mostly at the end of a period of premium payment (thus prior to the due date of the next premium). Claims already earned do not expire by cancellation in most cases. Cancellation merely leads to an end of the obligation to pay premiums and the end of insurance coverage; accordingly, events occurring after the cancellation has become effective are not included in the claim for benefits.

It can also be agreed that a fixed-term contract will be extended – for a maximum term of one year each time – if none of the parties cancels the contract in time. This way gaps in coverage can be avoided for the benefit of the insurance holder. If the contract is concluded for a term in excess of 5 years, the law provides the insurance holder’s right of cancellation at the end of the fifth year and each following year. This is important because contracts over such long periods can be entered into effectively on the basis of AGB/AVB as well.

2.5.2 Inception of Liability

It is noteworthy with reference to the inception of liability that the VVG stipulates the so-called payment-of-first-premium clause (“Einlösungsklausel”) as a basic rule: Accordingly, the insurer starts being liable only from the time the insurance holder has made the first premium payment.

If the customer is meant to be granted insurance cover prior to the first premium payment, the statutory provision can be waived to the effect that the insurer is liable immediately upon the formal conclusion of the contract, or from the point in time defined by contractual provision, either dependent on or regardless of the insurance holder’s premium payment by that time.

In that case it is agreed that the insurance holder pays the first premium immediately, or immediately upon receipt of the corresponding insurer's invoice. In insurance practice this proceeding is referred to as an extended payment-of-first-premium clause.

It happens quite often that an interested party requires the immediate coverage of a risk, whereas the insurer on the other hand needs to assess that risk thoroughly. For the time the insurer's scrutiny takes, the contracting parties can enter into a preliminary contract. That is the subject matter of the so-called provisional cover which represents an independent contract of insurance. It runs out automatically if the insurer ultimately declines the interested party's request or if the main contract is concluded, or if the provisional cover was limited to a certain period of time and has expired. There are no special formal requirements to be complied with; those contracts can even be concluded verbally, usually the case if contracts are "arranged" by an insurance broker.

A common practical case: If an integrative request is made for the conclusion of third-party motor liability insurance and fully comprehensive ("Kasko") insurance, the issuance of a "confirmation of insurance coverage" indicates the unqualified acceptance of a request for provisional coverage: The insurance holder is covered provisionally over the Kasko scope. The insurer can prevent this from happening only if he expressly excludes comprehensive insurance.

2.5.3 Other Termination of Contract

It is also noteworthy that the contracting parties' amicable cancellation of the insurance contract remains possible at any time. There are no formal requirements so that a cancellation agreement can be made verbally or by conduct implying such intent.

Unlike the insurance holder, the insurer can also withdraw from the contract of insurance. Withdrawal is an option if the first premium is not paid in due time or if the pre-contractual duty to give notice is deliberately violated (cp. Sect. 4.8). If the insurance holder does not pay the first premium in due time, the insurer can either withdraw from the contract or file a suit for payment. If he remains inactive for 3 months from the due date, his conduct is regarded as withdrawal according to law. The withdrawal results in a reversed transaction relationship between the contracting parties: Both are obliged to restitute payments received; however, the insurer may request a reasonable expense charge.

If the insurance holder has culpably violated notification duties, the insurer can declare withdrawal within a month from gaining knowledge. Withdrawal leads to exemption from performance if the other conditions according to law are fulfilled. In particular, the insurer must furnish proof that his notice of withdrawal has been received by the insurance holder.

The insurance holder is entitled to cancellation in case of a premium increase. If the insurer raises the premium on the basis of an adjustment clause contained in his AVB, the insurance holder can cancel the contractual relationship within a month

from the notice's receipt. This right of cancellation is provided only if the insurer has not expanded the scope of insurance coverage as well.

3 Classification of Different Kinds of Insurance

According to certain criteria, insurance can be classified into distinct groups:

3.1 Personal and Non-Personal Insurance

Personal insurance covers biometric risks. The term includes life, health, and personal accident insurance.

Non-personal insurance especially covers cost risks and liability. All kinds of property, third-party, and other assets insurance belong in this category. Real estate insurance and title insurance are two examples.

3.2 Insurance Against Loss and Fixed-Benefit Insurance

Insurance against loss covers the specific quantum of damages in the occurrence of the event insured. It can be grouped into insurance against the impairment of assets ("Aktivenversicherung") and insurance against the creation of liabilities ("Passivenversicherung"). The former secures a company's tangible assets. Examples for this category are building insurance and fully comprehensive ("Kasko") insurance.

Insurance against the creation of liabilities covers third-party liability, i.e. the company's liabilities are protected, e.g. by product liability insurance or third-party motor insurance.

Within the contractual framework of insurance against loss, a certain sum insured is agreed on which merely defines the maximum insurance amount. Typical examples of insurance against loss are health insurance, homeowners insurance, liability insurance, reinsurance, and motor insurance.

Fixed-benefit insurance provides a predefined fixed benefit in the occurrence of the event insured. This category is made up entirely of personal insurance. The most prominent example is life insurance, another one is personal accident insurance.

4 VVG Reform as of January 1, 2008

Since January 1, 2008 new provisions have been in effect, particularly in support of the rights of insurance holders. The new law is effective for all contracts of insurance concluded since January 1 as well as for all existing contracts (with the exception of

the calculation of so-called surrender values). Against this background, the following innovations are of particular significance:

4.1 Discontinuation of the All-or-Nothing Principle

The insurance holder's breaches of duties – for instance giving belated notice of the event insured – previously lead to the total loss of insurance coverage in accordance with the all-or-nothing principle. Now the consequences of a breach of duty shall be weighted according to the degree of the insurance holder's fault. As a result, the insurer is basically entitled only to reduce the amount of the insurance benefits.

4.2 Gross Negligence

Previously the insurance holder had to pay all damages arising from an event insured caused by his gross negligence himself (example: water damage from leaving the apartment with the washing machine running). Now the insurer may only cut the claim for benefits by an appropriate percentage corresponding to the degree of negligence.

4.3 Insurance Broking

New far-reaching duties to supply proper information and advice have been introduced for insurance brokers. The broker is liable for damages in case of flawed advice. The consultation shall be documented. This provision is supposed to provide increased legal security to the insurance holder in case of conflict. Furthermore, all necessary documents must have been issued to the customer by the time of reaching agreement. It used to be sufficient if, e.g. the general terms and conditions of the contract were handed over later together with the insurance policy.

4.4 Legal Venue

Previously insurance holders were required to be willing to travel as the insurance companies generally had to be sued at the locations of their head offices. Now for insurance contracts concluded in accordance with the reformed VVG, the legal venue follows the residence of the insurance holder who is now able to sue his insurer in his hometown.

4.5 Abandonment of the Cut-Off Period

The previous cut-off period of 6 months for taking legal action has been abolished. Until the revision came into force, the insurance holder had to sue upon his claim for insurance benefits within a period of 6 months if the insurer had declined to perform in writing. Since the beginning of 2008, the insurance holder can sue his insurer within a period of 3 years.

4.6 Direct Claim Against the Liability Insurer

The injured person's direct claim against the insurer has been implemented for all kinds of compulsory liability insurance. The previous provision only concerned third-party motor insurance.

4.7 Abandonment of the Principle of Premium Indivisibility

If the contract of insurance is canceled or terminated by withdrawal in the course of the insurance year, the insurance holder is obliged to pay the premium only until that time. The previous principle of the indivisibility of the premium has been abandoned. According to the previous legal situation, the insurance holder owed payment of the total annual premium even if the insurance contract was not terminated as of the end of the insurance period but sometime in the course of the insurance year.

4.8 Pre-Contractual Notification Duties of the Insurance Holder

As a basic principle, the insurance holder shall disclose the circumstances the insurer has inquired about in writing prior to the conclusion of the contract. The risk of misjudgment as to whether a circumstance is of relevance to the insured risk is thus transferred from the insurance holder to the insurer. The insurance holder is usually required only to disclose what had specifically been asked for. Breaches of the insurance holder's notification duties entitle the insurer to withdrawal from contract only if the insurance holder has deliberately provided incorrect statements. In case of gross negligence, the insurer may cancel the contract under certain conditions with effect for the future or demand the contract's continuation subject to changed conditions. Previously the insurer was entitled to the right of cancellation in all those cases.

4.9 Abandonment of the Policy Model

The so-called policy model – a national peculiarity – has been abandoned with the legal reform. The insurance companies are generally not too eager to turn over the general conditions of insurance (AVB) to their potential customers prior to the conclusion of the contract. In view of the abundance and limited intelligibility of the insurance conditions, they dread that the interested party might refrain from the commitment after all. According to the policy model, the potential customer used to file a request for the conclusion of an insurance contract. The AVB were delivered only after the insurer's acceptance.

Now the conditions of insurance must be handed out to the potential customer at the time of filling out the request. The consumer is thus given the opportunity to examine the legal product "insurance" thoroughly.

4.10 Other Innovations with Regard to the Individual Kinds of Insurance

In addition to the new provisions affecting the general provisions, a large number of innovations have been in force as of January 1, 2008 with regard to the individual kinds of insurance. With respect to life insurance, for instance, profit participation has been introduced for the benefit of the insurance holders who are now entitled to payment of half the hidden reserves, accumulated by the insurers on the basis of premium payments, upon termination of the contract. The return on life insurance is thus likely to increase. Prior to the law reform, insured persons did not participate in hidden reserves.

Transport Law and Forwarder Law

J. Walther

1 General Notes

In the course of the internationalization of the markets, the logistics sector is becoming increasingly important within the modern economic structure. The carriage of goods by land, air, or waterways is an essential aspect of economic activity. The autonomous delivery of goods is receding, to be replaced by the interaction of several parties in the carriage process. The carriage of goods and the resulting legal relationships are the subject of the following contribution which excludes the law of livestock transport and passenger transportation.

2 Legal Provisions of Transport Law

2.1 *Domestic Transport Law*

The German law of commercial goods transportation was newly framed by the Transport Law Reform Act (“Transportrechtsreformgesetz”), effective July 1, 1998. A summarization and modernization of the provisions spread over many different acts had become necessary. At the same time, international treaties of transport law were transposed into domestic law. Even though the new provisions followed the Convention on the Contract for the International Carriage of Goods by Road (CMR-Convention relative au contract de transport international de marchandises par route) in particular, ample space is left for the parties’ disposition, as based on the principle of private autonomy deviating agreements can be made in many cases.

With the reform of transport law, all provisions on the three typical categories of the transport business are now regulated in the Commercial Code (Handelsgesetzbuch–HGB). The freight business provisions are summarized in Sections 407 through 452d HGB. This business, representing the frame of reference for all other transactions under transport law, pertains to all kinds of freight business by road, rail, inland water transport, and aircraft, with the places of shipment acceptance and delivery in Germany. The forwarding business has its statutory framework in

Sections 453 through 466 HGB. The forwarder dispatches the goods by organizing the carriage and entering into the contracts required. The third essential transport business, the warehousing business, is regulated by Sections 467 through 475h HGB. Particulars of the separate transport businesses are discussed in Sect. 3. Special regulation is provided for the carriage of goods by sea. Maritime cargo law is comprised into Sections 556 through 663 HGB. Details can be found in Sect. 4.

2.2 International Provisions for Cross-Border Transportation

2.2.1 Road Transport Law

The international carriage of goods by road is regulated in the CMR (please refer to Sect. 2.1). Its provisions represent compulsory domestic law and thus must be generally observed. The CMR is applicable to every contract of carriage against payment providing the carriage of goods by road using vehicles, if the place of the acceptance of the shipment and the place designated for delivery as stated in the contract are situated in two different countries, of which at least one is a contracting state (see Article 1 (1) CMR).

Certain goods are excluded from the application of the CMR, e.g. international postal delivery, the carriage of human bodies, or the cross-border removal of furniture and household items (cp. Article 1 (4) CMR). The CMR is effective over the entire passage of transport regardless of the place of the occurrence of damage. According to Article 2 CMR, the Convention is also valid for the so-called combined transport, i.e. if the vehicle containing the goods is carried over parts of the distance by sea, rail, inland waterways or air and the goods are not unloaded, except in cases of insurmountable obstacles to uninterrupted carriage (cp. Article 2 (1) CMR).

2.2.2 Rail Transport Law

The Convention concerning International Carriage by Rail of May 9, 1980 (COTIF–Convention relative aux transports internationaux ferroviaires), last amended as of July 1, 2006, contains binding provisions for rail transportation. The legal foundations for the carriage of goods by rail are framed in Appendix B to the Convention, made up by the Uniform Rules concerning the Contract for International Carriage of Goods by Rail (CIM). The provisions of COTIF/CIM are mandatory if the places of acceptance and delivery of a transport of goods are situated in two different member states of the organization OTIF. The intergovernmental Organization for International Carriage by Rail, OTIF, composed of the contracting states of the Convention, was established to harmonize international rail traffic by creating and advancing uniform regulations.

The CIM uniform rules are applicable for goods consigned for carriage under a “through” CIM consignment note (cp. Article 1 section 1 CIM). Exceptions to the scope of application are made for shipments whose stations of dispatch and destination are situated in the territory of the same country and which pass through the territory of another country only in transit, provided the railway lines are operated exclusively by a railway of the country of departure and the countries or railways involved have agreed not to consider these kinds of consignments international (cp. Article 2 section 1 CIM).

2.2.3 Inland Waterway Transport Law

The Budapest Convention on the Contract for the Carriage of Goods by Inland Waterway of March 17, 2007 (CMNI – Convention de Budapest relative au contract de transport de marchandises en navigation interieure –), in force in the Federal Republic of Germany as of November 1, 2007, governs international inland waterway transportation between the contracting states. Since April 1, 2005 the Convention has already been in effect for cross-border consignments whose ports of loading or ports of discharge are situated in Bulgaria, Croatia, Luxembourg, the Netherlands, Romania, the Russian Federation, Switzerland, Czechia, or Hungary.

The CMNI is applicable to all freight contracts whose port of loading – or place of cargo acceptance – and port of discharge – or place of delivery – are situated in two different countries of which at least one is a states party to the Convention. If the contract provides for the option of several ports of discharge or places of delivery, the relevant port of discharge or place of delivery is the one to where the goods have actually been delivered (cp. Article 2 (1) CMNI). If the freight contract’s subject matter is the carriage of goods without transshipment by inland waterways as well as waterways subject to maritime regulations, this Convention is also applicable to said contract under the conditions of paragraph 1 unless a maritime bill of lading has been issued in accordance with applicable maritime law or the distance to be covered on waterways subject to maritime regulations is the greater one (cp. Article 2 (2) CMNI). It is important to note that the Convention is applicable regardless of the vessel’s nationality, home of registry or home port, its classification as seagoing vessel or inland navigation vessel, or the nationality, domicile, place of registered office or residence of the carrier, sender, or consignee (cp. Article 2 (3) CMNI).

2.2.4 Air Cargo Law

International air transportation finds its regulation in the Convention for the Unification of Certain Rules for International Carriage by Air of May 28, 1999 (“Montreal Convention”), amending significant provisions of the former Warsaw Convention’s regime. In Germany and the other EU member states, the Montreal Convention (MC) came into force as of June 28, 2004 for direct application.

The Convention is applicable to the international carriage of persons, baggage and cargo. “International carriage” means that according to the parties’ agreement the places of departure and destination are situated in the territories of two states parties, whether or not a break in the carriage or a transshipment occurs, or – if both places are situated within one country – an agreed stopover takes place within the territory of another country, even if that country is not a contracting state (cp. Article 1 (2) sentence 1 MC).

3 Typical Types of Contracts Under German Transport Law

3.1 Freight Contract

3.1.1 General Notes

The general provisions of German freight law contained in Sections 407 through 450 HGB are applicable for goods to be carried by land – i.e. by road or rail, by inland waterways or aircraft if the carriage is part of the operation of a commercial enterprise (Section 407 (3) HGB). Special regulation is provided for the carriage of goods for removal purposes (Sections 551 through 551h HGB) and carriage involving various modes of transport, the so-called multi-modal contracts (Sections 452 through 452d HGB).

Each freight business is based on a contract of carriage. There are no special formal requirements. Under the contract of carriage, the carrier is obliged to convey the cargo to the place of destination and deliver it there to the consignee. The sender or consignor is obliged to pay the agreed freight (Section 407 paragraphs 1 and 2 HGB). Contracting parties are accordingly the sender, i.e. the person who places the consignment, and the carrier who assumes the service of carriage. The recipient of the goods, the consignee, is not a contracting party and is therefore basically left outside the contract. However, the consignee is entitled to his own statutory claims, e.g. the right to demand the surrender of the cargo from the carrier, included in Section 421 (1) HGB.

The provisions of the German Commercial Code apply only to contracts of carriage to be executed in Germany in their entirety, which is why place of loading and place of discharge must be situated within the Federal territory. Goods are any objects intended to be carried from one place to another, whether the property is marketable or not. Objects intended to facilitate, simplify or secure the carriage of other objects, e.g. packaging material, containers or boxes, are also regarded as goods.

Agreements deviating from Sections 407 et seq. HGB are possible only to a limited extent. Section 449 HGB, containing special provisions, particularly restricts deviation if the sender is a consumer. However, individual agreements in favor of the consumer remain possible. Section 449 (2) HGB is applicable to all

transactions that do not involve consumers. According to said paragraph, deviations on the basis of individual negotiation are possible even to the detriment of the sender, provided the freight contract's subject matter is not the carriage of letters or similar postal items.

3.1.2 Rights and Obligations of the Sender

The sender's primary obligation is the payment of the freight agreed upon, Section 407 (2) HGB. Unless the circumstances or common usage indicate otherwise, the sender is also obliged to load, secure and unload the goods in such a way that their safe transport is secured (Section 412 (1) sentence 1 HGB). If the goods' nature requires packaging in consideration of the agreed mode of transport, the sender shall package the goods in such a way that they are protected against loss and damage and that no detriment to the carrier results from the packaging. If required for handling of the goods according to contract, the sender is also obliged to label the goods, Section 411 HGB. If the goods to be carried are dangerous, the sender must notify the carrier of the specific danger involved, in good time and in writing, and of precautionary measures to be taken if necessary, Section 410 HGB. In addition, the sender must provide the carrier with the shipping documents and furnish all information required for official treatment of the goods prior to dispatch, particularly customs clearance (see Section 413 (1) HGB).

Even if the consignment is not entirely loaded, the sender may demand the carriage of the goods from the carrier at any time, Section 416 HGB. In this case, however, the carrier is entitled to the full freight, demurrage, and the reimbursement of any additional outlays. The carrier is also entitled to demand further security to the extent the incompleteness of the consignment diminishes the carrier's full security, cp. Section 416 HGB.

The sender is entitled to the right of disposal with regard to the goods until they arrive at the place of delivery; Section 418 paragraphs 1 and 2 HGB. In particular the sender may stop or redirect the goods in transit. The right of disposal expires only upon the goods' arrival at the place of delivery when it is transferred to the goods' recipient. The sender may also terminate the freight contract at any time; Section 415 HGB contains particulars on the consequences of cancellation depending on the point in time the right of termination is executed.

3.1.3 Rights and Obligations of the Carrier

The carrier is obliged to carry and deliver the goods (Section 407 (1) HGB), with carriage meaning the shipment from the place of loading to a designated place of delivery. The carrier must see to it that the loading does not impede safe operation, Section 412 (1) sentence 2 HGB, and he is obliged to deliver the goods to the consignee. The carrier may use the services of third parties for the carriage; in that case he is responsible for their conduct according to Section 428 HGB.

The carrier may require the sender to issue a consignment note, Section 408 (1) HGB. This document serves as proof of conclusion and subject matter of the contract of carriage as well as the carrier's acceptance of the goods (Section 409 (1) HGB). It also substantiates the presumption that goods and packaging appeared to be in good shape at the time of the carrier's acceptance and that the number of goods and their marks and numbers correspond with the data stated in the consignment note unless the carrier enters a reservation, cp. Section 409 (2) HGB.

If the appropriate time period for loading or unloading is exceeded and the carrier is forced to wait, either based on contractual obligations or for reasons outside his sphere of risks, he is entitled to adequate reimbursement in the form of so-called demurrage, Section 412 (3) HGB. If the sender does not complete loading within loading time or if he does not provide the goods within that time period in the case he is not obliged to load, the carrier is further entitled to set an appropriate deadline for loading the goods or making them available, Section 417 (1) HGB. If those obligations are not fulfilled until the deadline, the carrier becomes entitled to terminate the contract and may either demand the agreed freight, less saved expenses or proceeds from another freight taken on instead or not taken on in bad faith, or a lump sum of one third of the agreed freight (so-called dead freight), Section 417 (2) HGB.

As the freight obligation becomes payable only upon the goods' delivery, implying the carrier's duty to render advance performance, he is entitled to a statutory carrier's lien for his security (Section 441 HGB). The lien secures any of the carrier's claims against sender and consignee based on the contract of carriage. The lien also extends to uncontested claims founded on other agreements between sender and carrier, e.g. freight, forwarding or warehousing contracts.

3.1.4 Rights and Obligations of the Consignee

As mentioned under Sect. 3.1.1, the recipient of the goods delivered by the carrier is not a contracting party of the contract of carriage and therefore basically left out of the contract's scope. However, as the consignee is actually entitled to own statutory claims – Section 421 HGB regulates the consignee's rights and his obligation to pay – the contract of carriage is a genuine third-party beneficiary contract.

According to Section 421 (1) HGB, the consignee is entitled to demand being delivered the goods by the carrier after they have arrived at the place of delivery in exchange for the consignee's fulfillment of his obligations stated in the contract of carriage (Section 421 (1) sentence 1 HGB), particularly the payment of the freight. If applicable, the consignee must also pay the demurrage or reimbursements for delayed loading or unloading in accordance with Section 421 (3) HGB.

With the arrival of the goods at the place of delivery and the demand of delivery, the right to issue instructions and the entitlement to claims for damage and loss during transport devolve upon the consignee. If the goods have been delivered damaged or with delay, the consignee is entitled to assert the claims under contract of carriage in his own name, Section 421 (1) sentence 3 HGB.

3.1.5 The Sender's Liability

There are four cases of the sender's liability in freight law, irrespective of fault, regulated in Section 414 HGB. Accordingly, the sender is liable to pay compensation to the carrier for damages and outlays caused by insufficient packaging or labeling, incorrectness or incompleteness of the information stated in the consignment note, failure to disclose the dangerous nature of the goods, or absence, incompleteness or incorrectness of the accompanying documents or information required for treatment of the goods by the authorities, Section 414 (1) HGB. The sender's secondary obligations defined in Sections 410, 411 and 413 HGB are thus comprised in one liability provision.

Liability for damages is limited to an amount of 8.33 units of account per kilogram of the shipment's gross weight, Section 414 (1) sentence 2 HGB. Compensation for the carrier's outlays remains unaffected by this aggregate limit of liability.

If the carrier's conduct has contributed to the causation of damages or outlays, the obligation to pay compensation and the extent of the compensation payable depends on the share that conduct had in causing the damages or outlays, Section 414 (2) HGB. Therefore the sender's liability is not dropped in its entirety in cases of the carrier's contributory causation of damage, as it is in case of application of the CMR.

3.1.6 The Carrier's Liability

The carrier's liability for damaged goods and delays is regulated in Sections 425 et seq. HGB. Similar to Article 17 CMR, Section 425 HGB stipulates that the carrier is basically liable for property damage and damage caused by delay occurring while he is in charge of the goods, i.e. between acceptance and delivery. Sections 426 through 439 HGB provide exemptions from and limitations of liability, however, qualifying that extensive custodial liability.

The carrier is exempt from liability insofar the loss, damage or delay is due to circumstances the carrier could not have avoided, even if he had exercised the utmost diligence, and whose consequences he could not have prevented, Section 426 HGB.

In addition to this basic exemption from liability, Section 427 HGB contains a catalog of special cases of exemption which also leans towards the CMR. The carrier is exempt from liability, for instance, if the loss or damage or exceeding the time of delivery is due to the sender's insufficient packaging (Section 427 (1) no. 2 HGB) or the sender's or consignee's handling, loading or unloading of the goods (Section 427 (1) no. 3 HGB). Liability is also excluded in the case of the goods' insufficient labeling by the sender (Section 427 (1) no. 5 HGB) or with reference to the natural condition of the goods exposing them to easy damage, particularly by breakage, rust, decay, desiccation, leakage, or regular wastage (Section 427 (1) no. 4 HGB). If damage has occurred which might have resulted from one of the risks specified in Section 427 (1) HGB according to the circumstances, it is presumed that the damage has indeed been caused by this risk (Section 427 (2) HGB).

However, this presumption can be rebutted by the sender, furnishing proof in rebuttal that the risk was not causal.

The carrier is liable for the conduct of assistants and agents according to Section 428 HGB. His responsibility includes the actions and omissions of his assistants and other persons he uses for the performance of the carriage as if they were his own, insofar as those persons' conduct is associated with the execution of their duties.

The strict liability provisions for the carrier are mitigated by limits of liability. Sections 429 through 433 HGB regulate the extent of liability. The carrier who is liable for compensation of partial or total loss of the goods only needs to pay the shipment value, i.e. the goods' value at the place and time of acceptance for transport, Section 429 (1) HGB. According to Section 432 HGB, compensation for other costs is limited to public duties and taxes, as well as other expenses caused by the carriage of goods, e.g. transport insurance premium or demurrage. He is not liable for any further damage, Section 432 (2) HGB, especially consequential damage or loss.

Another limit of liability is contained in Section 431 HGB, governing the carrier's maximum liability. Compensation for damage or loss of the total shipment is limited to the amount of 8.33 units of account per kilogram of the shipment's gross weight, Section 431 (1) HGB. If only one or several packages of the shipment are damaged or lost, the carrier's liability is also limited to the amount of 8.33 units of account per kilogram of the total shipment's gross weight, if the entire shipment is devaluated, or of the devaluated part's gross weight, if only a part of the consignment has lost its value (Section 431 (2) HGB). Compensation for damage caused by delay is limited to the threefold amount of the freight, Section 431 (3) HGB. For other pecuniary loss neither caused by the goods' loss or damage nor by exceeding the delivery period and for other damage which is not damage to goods or persons, Section 433 HGB stipulates the threefold amount payable in event of total loss as maximum liability.

The exemptions from and limits of liability provided by Sections 407 through 450 HGB and the contract of carriage also apply to the sender's or consignee's non-contractual claim against the carrier because of the goods' damage or loss or non-compliance with the delivery period, Section 434 (1) HGB. This is so particularly for the claims in tort concurring with the contractual claims. Under certain conditions, the same applies to non-contractual claims of non-contracting third parties founded on the goods' loss or damage, Section 434 (2) HGB.

According to Section 435 HGB, the statutory exemptions from and limits of liability do not apply if the damage is a result of an action or omission of the carrier, an assistant, or one of the persons used in accordance with Section 428 HGB, either done with the intent to cause damage or with recklessness in the knowledge that damage would probably occur. If the requirements of Section 435 HGB are met, the carrier is obliged to compensate the claimant for direct damages as well as consequential damage.

The limitation provision contained in Section 439 HGB corresponds with Article 32 CMR content-wise. The limitation period is 1 year, extended to 3 years in cases of intent and recklessness, Section 439 (1) HGB. Limitation basically begins with the delivery of the goods, cp. Section 439 (2) HGB.

3.1.7 Multi-Modal Transport

Combined or multi-modal transport concerns the carriage of goods involving various modes of transportation, gaining in practical importance increasingly. If combined transport is used, it must be taken into consideration that different provisions may apply for the separate modes of transport or stretches of carriage which might differ significantly or even collide with each other. In the specific case of damage this may become important for liability issues if, e.g. the precise place where the damage occurred is not known. Special regulations are comprised in Sections 452 through 452d HGB for the first time.

The contract for the carriage of goods involving various modes of transportation is a freight contract, differing from the unimodal transport solely by the choice of several different means of transport. The overall carriage – e.g. the transportation of containers first by truck, then by rail, then by rail or aircraft, then again by rail and truck – must be based on a single integrative contract of carriage.

If the carriage of goods is executed on the basis of an integrative freight contract using different means of transport, Sections 407 through 450 HGB are applicable for that contract – Sections 452a through 452d HGB or applicable international treaties notwithstanding – provided that, if the contracting parties had entered into separate contracts for each stretch of carriage executed with one means of carriage, at least two of those contracts would have been subject to different statutory provisions, cp. Section 452 HGB.

If it is certain that, e.g. the loss or damage or the event that lead to exceeding the delivery period occurred on a certain stretch, the carrier's liability is determined in accordance to the liability provision which would have been applicable to a (hypothetically concluded) separate contract of carriage for that stretch, Section 452a HGB. If the place where the damage occurred is unknown, the general provisions of Sections 407 ff HGB apply.

3.2 Forwarding Contract

3.2.1 General Notes

The forwarding business is regulated in Sections 453 through 466 HGB. The forwarding contract carries the obligation to provide the goods' shipment. This means the organization of transport, not the actual carriage of the goods. The contracting parties of the forwarding contract which does not have any formal requirements are the sender and the forwarder.

The contracts necessary for the carriage are usually concluded in the forwarder's name but on the sender's account, Section 454 (3) HGB.

In addition to Sections 453 et seq. HGB, the General German Forwarding Terms ("Allgemeine Deutsche Spediteursbedingungen" – ADSp) must be complied with. However, the ADSp only have restricted validity due to Section 466 HGB, and they do not apply to consumer contracts in the first place.

3.2.2 Rights and Obligations of the Sender

The sender's primary obligation is to pay the agreed remuneration. The sender is also obliged to package and label the goods if necessary and to supply the documents or furnish the information the forwarder needs for fulfilling his obligations. If dangerous goods are meant to be shipped, the sender shall notify the forwarder of the specific kind of danger and, if necessary, of the precautionary measures to be taken, in writing and in good time, cp. Section 455 (1) HGB.

The remuneration is payable by the time the goods have been turned over to the carrier or shipper (Section 456 HGB). Payment is therefore an advance performance.

3.2.3 Rights and Obligations of the Forwarder

The forwarding contract obliges the forwarder to arrange the dispatch of the goods, Section 453 HGB. In doing so, he shall look after the sender's interests and carry out his instructions, Section 454 (4) HGB.

For this purpose he organizes the carriage, especially by determining the means and routes of transportation, choosing the performing companies, concluding the agreements necessary for the carriage, and furnishing the required information and giving the necessary instructions to the performing enterprises (cp. Section 454 (1) HGB). According to that Section, the forwarder shall secure the sender's possible claims for damages as well. An additional obligation of the forwarder is the performance of other agreed services with regard to the dispatch, such as the goods' insurance and packaging, labeling, and customs treatment, Section 454 (2) HGB.

The forwarder is authorized to arrange the goods' dispatch together with the goods of another sender, on the basis of a freight contract for a collective consignment entered into on his own account, Section 460 (1) HGB. In that case he has the rights and obligations of a carrier with regard to the carriage as a collective consignment, cp. Section 460 (2) HGB.

The forwarder is also authorized to perform the carriage of the goods as a self-contracting party (cp. Section 458 HGB). If he does, he is also committed to the carrier's rights and obligations, and he may claim the usual freight in addition to his remuneration as forwarder.

According to Section 464 HGB, the forwarder has a lien over the goods for all claims founded on the forwarding contract and for uncontested claims resulting from other forwarding, freight and warehousing contracts concluded with the sender, Section 464 HGB. Thus his claims are specially secured.

3.2.4 The Sender's Liability

Even if he is not at fault, the sender must compensate the forwarder for damages and outlays caused by insufficient packaging and labeling, failure of notification of the goods' dangerous nature, or absence, incompleteness and incorrectness of the

documents or information required for the official treatment of the goods, Section 455 (2) HGB. This liability irrespective of fault does apply for the sender only if he is not regarded as a consumer.

Maximum liability is in effect in the same form as applies to the freight contract. If the sender is a consumer, he must compensate the forwarder for damages and outlays only if they have been caused through his fault, Section 455 (3) HGB.

3.2.5 The Forwarder's Liability

The forwarder is liable for damages resulting from the goods' loss or damage while in his custody, Section 461 (1) HGB. The Section refers to the liability system of the freight contract for the particulars of the forwarder's liability (see Sect. 3.1.6 above). Thereby a largely equal treatment of the carrier's and the forwarder's liability for damaged goods is provided. According to Section 461 (1) HGB read in conjunction with Section 426 HGB, the forwarder's liability does apply, irrespective of fault, if the goods are in the custody, or possession, of the forwarder. This is the case for instance if the goods are in the forwarder's warehouse for handling purposes at the occurrence of damage.

The forwarder is responsible for his assistants' and agents' actions and omissions to the same extent as for his own if they act in execution of their duties. The same applies for the actions and omissions of other persons the forwarder uses for fulfilling his primary obligation to arrange the dispatch of the goods, Section 462 HGB.

The provisions of Sections 453 et seq. HGB are in part non-mandatory and can be replaced by individual agreements, Section 466 HGB. This provision equals the respective one that applies for the carrier. Accordingly, it is not allowed to deviate from the statutory provisions to the detriment of a consumer.

The limitation provision in Section 439 HGB for the freight contract applies accordingly (Section 463 HGB), see Sect. 3.1.6 above.

3.3 Warehousing Contract

3.3.1 General Notes

Warehousing law is regulated in Sections 467 through 475h HGB in its entirety. Even though the warehousing of goods with a stock keeper does occur in national trade as well, the warehousing contract is central particularly in international trade. If an enterprise does not have the necessary space and facilities for storage, warehousing with third parties usually proves more practical and cost-effective. The warehousing contract obliges the warehouse keeper to store the goods and keep them in safe custody while the depositor is obliged to pay the agreed remuneration; Section 467 paragraphs 1 and 2 HGB. There are no formal requirements. The forwarding transaction

occurs in the shape of single or collective storage. There is also the so-called “Summenlagerung” (bulk storage).

Goods in single or separate storage are stored separately. Contrary to that, fungible goods in collective storage are mingled with other goods of the same kind and quality; special provisions can be found in Section 469 HGB. Bulk storage is not covered by the warehousing contract as the warehouse keeper becomes the owner of the stored goods with the obligation to return goods of the same kind, quality and quantity. To this type of storage, Section 700 of the Civil Code is applicable.

3.3.2 Rights and Obligations of the Depositor

The depositor is obliged to pay the remuneration agreed upon (Section 467 (2) HGB). In addition to this primary obligation, he is obliged to compensate the warehouse keeper for his outlays to the extent it was reasonable for the latter to consider the outlays necessary, Section 474 HGB.

If dangerous goods are intended to be stored, the depositor is further obliged to notify the warehouse keeper of the specific nature of the danger and of precautionary measures to be taken, if necessary, in writing and in good time. If applicable, he shall also package and label the goods and provide all documents and furnish all the information required by the warehouse keeper for the fulfillment of his obligations, cp. Section 468 (1) HGB. Different provisions apply if the depositor is a consumer, see Section 468 (2) HGB.

The depositor may require the warehouse keeper to insure the goods, Section 472 (1) HGB. He can demand surrender of the goods at any time or terminate the warehousing contract in compliance with a 1-month period of notice, Section 473 HGB. If there is an important reason, termination is possible even without giving notice (Section 473 (1) sentence 2 HGB).

3.3.3 Rights and Obligations of the Warehouse Keeper

By warehousing contract the warehouse keeper is obliged to store the goods and keep them in safe custody, Section 467 (1) HGB. A warehousing contract provides either for single or collective storage, contrary to bulk storage also mentioned under 1.

The warehouse keeper is authorized to mingle fungibles with other goods of the same kind and quality if the depositors involved have given their express consent, Section 469 (1) HGB. In this case the warehouse keeper may return to each depositor the portion due to him irrespective of the approval of the other depositor(s) involved (Section 469 (3) HGB).

The warehouse keeper is entitled to compensation of his expenditures made on account of the goods to the extent it was reasonable to consider them necessary according to the circumstances, Section 474 HGB.

The warehouse keeper shall allow the depositor to inspect the goods, take samples and carry out any measures necessary for the goods' preservation during business hours. He is also entitled and, in the case of collective storage, obliged to carry out the measures necessary for the preservation of the goods himself, cp. Section 471 (1) HGB. If changes of the goods' condition are likely to occur or have occurred already after their receipt, which are likely to result in the goods' loss or damage or damage to the warehouse keeper, it is the warehouse keeper's duty to notify the depositor or, if a warehouse warrant has been issued, the warrant's last legitimate holder known to him. The warehouse keeper shall ask the depositor or holder of the warrant for instructions. If necessary, he must take appropriate action for preventing or reducing the damage himself (Section 471 (2) HGB).

If requested by the depositor, the warehouse keeper is also obliged to insure the goods in his storage, Section 472 HGB.

The warehouse keeper is entitled to request the depositor to take back the goods after the expiry of the agreed storage period or upon termination of the contract 1 month after giving notice in the case of storage for an indefinite period, Section 473 (2) sentence 1 HGB. If there is an important reason, termination is possible without observing a period of notice (Section 473 (2) sentence 2 HGB).

The warehouse keeper has a lien over the goods for all claims founded on the warehousing contract as well as uncontested claims arising from other warehousing, freight or forwarding contracts concluded with the depositor, extending to claims from an insurance policy and the accompanying documents (Section 475b (1) HGB).

3.3.4 The Depositor's Liability

Irrespective of fault, the depositor must compensate the warehouse keeper for damages and expenses caused by insufficient packaging or labeling, failure of notification of the dangerous nature of the goods, or absence, incompleteness or incorrectness of the accompanying documents or information furnished in accordance with Section 413 (1) HGB. If it is a consumer transaction, the depositor is liable only for damages caused through his fault, Section 468 HGB.

3.3.5 The Warehouse Keeper's Liability

The warehouse keeper is liable for damages pertaining to the goods' loss or damage in the period between acceptance for storage and return, unless the damages could not have been avoided by exercising the diligence of a prudent merchant. This also applies if the warehouse keeper was authorized to store the goods with a third party, cp. Section 475 HGB.

With regard to the limitation period, Section 439 HGB for freight contracts applies accordingly (Section 475a HGB), see Sect. 3.1.6 above.

4 Maritime Cargo Law

4.1 General Notes

Sections 556 through 663 HGB apply to the carriage of goods by sea, accounting for the separate fourth section of the fifth book of the Commercial Code, regulating maritime trade. The general provisions of transport law do not apply to maritime cargo law. It is generally possible to deviate from the statutory provisions by individual agreement. However, this option is largely restricted if a bill of lading is issued (for details, please refer to Sect. 4.2.5 below).

The law of the carriage of goods by maritime trade as contained in the German Commercial Code refers to the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading of August 25, 1924 (“Hague Rules”). By the Second Maritime Law Amendment Act of July 25, 1986, the so-called “Visby Rules” were incorporated in particular, amendments to the Hague Rules made in the year 1968. Thus domestic law complies with the international legal standard even though the Federal Republic of Germany has never ratified the Visby Rules, thereby denying them any formal acceptance in terms of public international law.

Questions arising in international maritime cargo law with regard to the purview of German maritime cargo law are to be solved in compliance with Article 6 EGHGB (Introductory Act to the German Commercial Code). Generally speaking, intrastate and international carriages find integrative treatment under the law of maritime transport.

4.2 Arrangements of the Maritime Freight Contract in Detail

The maritime freight contract obliges the sea carrier to the carriage of goods by sea against the shipper’s payment. The freight contract does not have formal requirements. Section 556 HGB distinguishes between freight contracts referring to the carriage of separate goods as so-called general cargo or to the vessel on the whole, a portion, or a specifically indicated part of the vessel.

Involved in a maritime freight transaction are the sea carrier, the shipper, the “Ablader” (there is no equivalent English term), and the receiver. The sea carrier has the position assumed by the “carrier” in the carriage of goods by land. He takes on the carriage of goods by sea against payment of the freight. The sea carrier can be the owner and supplier of a seagoing vessel at the same time. The contracting party of the sea carrier is the shipper. The shipper owes the sea carrier the payment of the agreed freight. The shipper therefore corresponds with the “sender” in the road transport business. The third party involved in the maritime freight business is the Ablader. The Ablader is the person who physically delivers the goods to the vessel in his own name on the basis of the contract of carriage with the shipper. It is possible, however, that the shipper and the Ablader is one and the same person.

The last person involved in the transport transaction is the receiver to whom the goods are delivered.

4.2.1 Rights and Obligations of the Sea Carrier

The freight contract obliges the sea carrier to carry the goods by sea to a designated place and to deliver the goods to the receiver. Against payment of the freight and the fulfillment of other obligations by the receiver, the sea carrier shall surrender the goods to him (Section 614 (2) HGB). The sea carrier has to take care that the vessel is in seaworthy condition and that the cargo holds including cold storage and freezer rooms are in suitable condition for the reception, transportation and preservation of the goods, cp. Section 559 HGB. In loading, stowing, carrying, handling and discharging the goods, the sea carrier is obliged to execute the diligence of a prudent sea carrier, Section 606 HGB.

The expenses for loading as well as discharging the goods are to be paid by the sea carrier (Sections 561, 593 HGB). To make loading possible, the captain must berth the ship at the place designated by the sea carrier, Section 560 (1) HGB.

The sea carrier shall issue a bill of lading (“Konnossement”) to the Ablader upon the latter’s request as soon as the goods are loaded on board, Section 642 (1) HGB. From the bill of lading, certain indispensable obligations of the sea carrier result as stipulated by Section 662 HGB, as well as the corresponding carrier’s liability, discussed in detail under Sect. 5. below.

On request of the shipper, the sea carrier shall accept other goods offered to him for transportation to the same port of destination instead of the goods initially agreed upon if his task is not complicated by this change and if the goods to be carried are not specifically indicated in the contract, cp. Section 562 HGB.

The sea carrier is not authorized to transship the goods on board of another vessel without the shipper’s approval (Section 565 (1) sentence 1 HGB). Neither is he authorized to carry the goods on deck or suspend them from the ship’s sides without the shipper’s consent (Section 566 (1) HGB).

If delays occur during the reception of the goods, the sea carrier shall wait beyond the agreed loading time. The sea carrier may cease to wait for unloading if he declares to the shipper at least 3 days prior to the expiry of loading time or the extra lay days that he is no longer willing to wait for unloading (Section 570 (1) HGB). If the sea carrier, however, has made it a condition that unloading must be completed by a certain day, he is not obliged to wait if the shipment is delayed (Section 576 HGB). The sea carrier is owed a so-called demurrage for the waiting period (Section 574 HGB), the amount of which is to be determined as appears just unless it is determined in the freight contract (Sections 572 (1) HGB). If the sea carrier is supposed to receive the goods from a third party and that third party – regardless of the sea carrier’s readiness for loading having been announced according to local custom – cannot be identified or refuses delivery of the goods, the sea carrier shall inform the shipper about this situation expeditiously, and he shall wait for unloading only until expiry of the agreed loading time and not for extra lay days

if applicable unless given instructions to the contrary by the shipper within loading time (cp. Section 577 (1) HGB).

The sea carrier is obliged to start the voyage upon the shipper's request even without the full determined cargo. His claim for the full amount of the agreed remuneration remains unaffected. He is further authorized to request an additional security if he misses out on the security for the full cargo due to its incompleteness and to request compensation from the shipper for the additional expenses incurred because of the cargo's incompleteness (Section 578 HGB).

If the shipper delivers only a part of the cargo until expiry of the waiting time, the sea carrier is authorized to start the voyage and to require the shipper to pay compensation for possible extra expenses in addition to the total freight and possible demurrage, and he may require an increased security unless the shipper has withdrawn from the contract, cp. Section 579 HGB. If no cargo is delivered within the waiting period, the sea carrier is no longer bound by his contractual obligations and entitled to claim dead freight, Section 585 HGB. If the subject matter of the contract is general cargo, there are different provisions for the shipper's default. In case of the shipper's default, the sea carrier is not obliged to wait for the goods' delivery if general cargo is concerned (Section 588 (2) sentence 1 HGB). Even if the ship eventually casts off without the cargo, the shipper must still pay the total freight amount.

The sea carrier is entitled to demurrage in case of the receiver's default, Sections 602 et seq. HGB.

As the claim to payment of the freight falls due only upon the cargo's delivery, thus committing the sea carrier to advance performance, he is entitled to a lien for his security (Section 623 HGB). The lien secures all claims founded on the respective maritime freight contract against the receiver.

4.2.2 Rights and Obligations of the Shipper

The shipper's primary obligation is the payment of the agreed freight. Different provisions by contract, local regulation or local custom notwithstanding, the shipper shall deliver the goods to the ship free of charge, Section 561 HGB. The obligation to pay ceases to apply as soon as the receiver is obliged to pay with the delivery of the goods to him, Section 625 HGB.

With each type of freight contract, the shipper is obliged to provide the captain with all the documents necessary for shipment, within the time period set for delivering the goods, Section 591 HGB. The shipper is further obliged to make correct statements to the sea carrier about the goods' measurements, quantity or weight as well as their marks. If inflammable, explosive or otherwise dangerous goods are carried on board, the captain shall be notified.

The shipper may require the sea carrier to accept other goods to be shipped to the same port of destination instead of the goods referred to by contract, Section 562 (1) HGB. The shipper may require the sea carrier to start the voyage even without the complete cargo. In that case, however, the shipper must pay the total

freight plus demurrage, if applicable, and additional securities and additional expenses incurred due to the cargo's incompleteness.

If loading the goods on board is delayed beyond loading time, the shipper shall pay so-called demurrage to the sea carrier for the extra lay days, Section 567 (4) HGB.

The shipper may withdraw from the contract prior to the start of the sea voyage. If he does, he is obliged to pay so-called dead freight ("Fautfracht"), amounting roughly to half of the freight as agreed upon, cp. Section 580 HGB. After departure a withdrawal from the contract and unloading of the cargo is possible only if the total freight is paid and all other claims of the sea carrier are met as well, Section 582 HGB. Even after unloading, the shipper may withdraw from the contract and require the discharge of the goods against payment of the total freight and all other obligations, Section 589 HGB.

If the goods are not accepted by the receiver, the shipper is obliged to satisfy the sea carrier with regard to the freight and all other claims according to the contract of carriage, Section 627 (1) HGB.

4.2.3 Rights and Obligations of the "Ablader"

The Ablader ist obliged to deliver the goods to be shipped to the vessel. Without his approval, the goods may neither be carried on deck nor suspended from the ship's sides (Section 566 HGB).

On the Ablader's request, the sea carrier has to issue a bill of lading to the Ablader without delay, against return of the preliminary delivery receipt or received bill of lading if issued upon the goods' acceptance, in as many copies as requested as soon as the goods are taken on board (Section 642 (1) HGB). The Ablader shall return a copy of the bill of lading bearing his signature to the sea carrier upon his request, Section 642 (3) HGB. With the Ablader's consent, the bill of lading may be also issued for goods accepted for shipment but not yet taken on board, Section 642 (5) sentence 1 HGB. If requested by the Ablader, the bill of lading must contain the goods' measurements, quantity or weight, their marks, and their outwardly identifiable condition and nature in the form in which the Ablader has communicated these particulars in writing prior to the beginning of loading (Section 645 (1) HGB).

4.2.4 Rights and Obligations of the Receiver

The receiver is the person to whom the shipped cargo is to be delivered (Section 592 (1) HGB). He is entitled to demand the delivery of the goods.

If issued, the bill of lading whose required components are regulated in Section 643 HGB is decisive for the legal relationship between sea carrier and receiver of the goods (Section 656 (1) HGB). The bill of lading substantiates the presumption that the sea carrier took over the goods as described by the statements in the bill of lading (Section 656 (2) sentence 1 HGB).

The receiver is entitled to instruct the captain at which loading berth the ship's cargo shall be discharged, Section 592 (1) HGB. By receiving the goods, the receiver is obliged to pay the freight and all incidental charges plus demurrage if applicable, customs duties outlaid and other expenses, and to fulfill other obligations in compliance with the contract of carriage or the bill of lading on the basis of which the receipt occurs, cp. Section 614 (1) HGB. The sea carrier must deliver the goods against payment of the freight and fulfillment of the other obligations of the receiver, Section 614 (2) HGB. Provisions to the contrary by agreement, local regulation or local custom notwithstanding, the receiver has to bear the costs of the cargo's discharge except for the costs of unloading, which shall be borne by the sea carrier, Section 593 HGB.

Freight needs not be paid for goods lost by accident; prepaid freight must be reimbursed if applicable (Section 617 (1) HGB). Regardless of failed delivery, the freight must be paid for goods whose loss is the consequence of their natural condition, i.e. loss by deterioration, shrinkage or ordinary leakage, or for animals dying in transit (Section 618 HGB). Additional provisions on the amount and scope of the freight are contained in Sections 619 et seq. HGB. They are applicable if the bill of lading does not provide a statement on the freight amount.

The receiver shall accept general cargo upon the captain's request without delay (Section 604 (1) sentence 1 HGB); however, he may have the cargo inspected by the proper authorities or the expert officially recognized for those tasks prior to acceptance in order to determine the condition of the goods or their measurements, quantity or weight (Section 610 HGB). Loss of or damage to the goods must be indicated in writing to the sea carrier or his representatives at the port of discharge not later than the goods' delivery, unless the loss or damage was not recognizable on the surface. In that case it is sufficient to mail the notification within 3 days after the acceptance of the goods (Section 611 (1) HGB).

If the carriage concerns a whole ship, the captain shall notify the receiver as soon as he is ready for discharge (Section 594 (1) HGB). The discharge time begins the day after the day of notification (Section 594 (3) HGB). Demurrage must be paid in the case of delayed receipt (Section 598 HGB). If the receiver agrees to the receipt of the goods, yet the receipt is delayed in excess of the period to be observed by him, the captain is authorized to deposit the goods at a public warehouse or at another safe place of storage upon notification of the receiver. The captain is obliged to act that way, and notify the shipper at the same time, if the receiver declines acceptance of the goods or does not make any statement on the acceptance of the goods after being notified of the readiness for discharge, or if the receiver cannot be identified (cp. Section 601 HGB).

4.2.5 The Sea Carrier's Liability

The sea carrier is liable for the damage based on a lack of seaworthiness or cargo-worthiness unless that lack could not have been detected in executing the diligence of a prudent carrier prior to the start of the voyage (Section 559 (2) HGB). He is also liable for the damages arising from loss of or damage to the goods between their acceptance and delivery unless the loss or damage is based on circumstances which

could not have been prevented by execution of the diligence of a prudent carrier (Section 606 (2) HGB). The sea carrier is responsible for the fault of his assistants and agents and the crew to the same extent as for his own, Section 607 (1) HGB.

The liability of the sea carrier is limited. Under the condition of certain special circumstances, the sea carrier is exempt from liability. However, the statutory exemptions from liability and limitations of liability only apply to the claim held against the sea carrier for the compensation of damages arising from the loss of or damage to the goods that are the subject matter of the contract of carriage, regardless of the claim's cause in law, Section 607a (1) HGB.

The total amount to be paid in compensation must not exceed the maximum liability as stipulated by Section 660 HGB. For damage to goods, the sea carrier must compensate the difference between the goods' selling price in damaged condition and the current trade value or ordinary value the goods would have had undamaged at the place of destination at the time of discharge, less the amount saved in the shape of customs duties and other expenses as a result of the damage, cp. Section 659 HGB.

Unless the kind and value of the goods have been indicated by the Ablader prior to loading and this information has been included in the bill of lading, in each case the sea carrier is liable for the goods' loss and damage to the maximum amount of 666.67 units of account per package or other unit, or two units of account per kilogram of the gross weight of the goods lost or damaged, depending on which amount of the two is the higher one. The so-called unit of account is the special drawing right of the International Monetary Fund; the amounts are converted into euros on the day of the judgment or on the day agreed on by the contracting parties, according to the value of the euro against the special drawing right (Section 660 (1) HGB). This limitation of liability does not apply, however, if the damage is attributable to an action or omission of the sea carrier with the intent to cause damage or with recklessness and the awareness that a damage would probably occur (Section 660 (3) HGB).

According to Section 608 HGB, there is no liability for damages arising because of incalculable circumstances, such as the perils, dangers and accidents of the sea, provided the sea carrier is not responsible for the circumstances on which the occurrence of the danger is based.

It is of importance for the liability of the sea carrier if a bill of lading has been issued. If it is, a large number of the sea carrier's obligations as described above cannot be exempted or limited in advance, Section 662 HGB. Therefore it makes sense to work towards the issue of a bill of lading.

4.2.6 The Shipper's Liability

Section 563 HGB stipulates the shipper's liability irrespective of fault with regard to the information he furnishes to the sea carrier concerning the measurements, quantity or weight of the goods to be shipped, and their marks. Regardless of fault, the shipper is liable for the sea carrier's damages arising from the incorrectness of his statements. He is liable for other persons' damages only if they have arisen through his fault, see Section 563 (1) HGB.

If the shipper makes incorrect statements about the kind and nature of the goods, he is liable for damages only if he is to blame for that incorrectness, Section 564 HGB. The shipper's liability also applies if inflammable, explosive or otherwise dangerous goods are carried on board without the captain's knowledge of those goods or their dangerous nature or condition, Section 564b (1) HGB. In that case, the shipper's liability is irrespective of fault.

4.2.7 Liability of the "Ablader"

With regard to the statements about the measurements, quantity or weight of the goods and their marks, or the kind and condition of the goods, the liability of the Ablader equals the shipper's liability. The same holds true for carrying inflammable, explosive or otherwise dangerous goods on board. Details can be found under Sect. 4.2.6 above.

4.2.8 Termination of the Maritime Freight Contract

If the shipper is not able to make the cargo available in time, shipper and sea carrier are entitled to withdraw from the contract, as has been described under Sects. 4.2.1 and 4.2.2. The sea carrier's exceptional right to terminate the contract prior to the start of the voyage is based on the provision of Section 580 (1) HGB.

Sections 628 through 641 HGB contain special provisions for the termination of a maritime freight contract. It must be taken into consideration that contractual agreements will usually have priority over those statutory provisions. The following individual provisions are of importance:

If prior to the start of voyage either the ship gets lost or the goods get lost accidentally – whether specially indicated in the freight contract or not – after they have been carried on board or accepted for loading by the captain at the loading berth, the contract of carriage becomes ineffective without resulting in liability of any of the persons involved for anyone's damages, Section 628 (1) HGB. If goods not specially indicated have been lost, the contract does not become ineffective if the shipper agrees without delay to deliver other goods instead of the lost ones, and if he starts the delivery within the waiting period, Section 628 (2) HGB.

A special right of rescission is provided by Section 629 HGB in case an embargo is imposed on the ship prior to the start of the voyage or the shipment is prevented from traveling on similar grounds, or a war breaks out so that the ship or the goods to be shipped according to the freight contract, or both, cannot be considered free to move and would be exposed to the risk of capture, Section 629 (1) HGB. In that case, liability for the compensation of damages ceases to apply as well.

If the ship accidentally gets lost after the voyage has started, the contract of carriage is terminated. If goods are salvaged or retrieved, the shipper must pay part of the freight in the ratio of distance traveled to total distance. This so-called "pro rata freight" is payable only to the maximum amount of the value of the salvaged

goods (Section 630 HGB). If the goods are accidentally lost after the start of the voyage, the contract of carriage is also terminated without leading to any liability for compensation among the persons involved, Section 633 HGB. If an embargo is imposed or another contingency takes place after the voyage is started, the result is a special right of rescission according to Section 634 HGB, not leading to liability for damages.

If the contract does not refer to the ship as a whole but rather to a portion or a specially indicated part of the ship, or to general cargo, Sections 628 through 640 HGB apply with certain deviations detailed in Section 641 HGB.

Customs Law

B. Kosny

1 Introduction

1.1 Historical Development

The foundation of the European Economic Community in the year 1958 carried the vision of creating a common economic area without boundaries for the free movement of goods of any kind. One of the first steps towards its realization was the foundation of a customs union in the year 1968. All member states agreed to eliminate their national customs duties and to comprise them in a single customs tariff for the trade between the European Community (EC) and third countries. In order to guarantee that all goods imported to the Community are subject to the same customs treatment throughout the EC, a reform of the existing customs law was necessary. One substantial measure was the introduction of a standardized customs declaration form, the so-called single administrative document, in the year 1988. The completion of the European internal market as of January 1, 1993 resulted in a common economic area. Since then the movement of goods between the EC member states is basically not subject to customs controls anymore and shipments do not have to be cleared through customs at the intra-community borders.

Even though the European Community was based primarily on the customs union, a great number of national legal provisions were still in effect in the member states into the 1990s. In the course of the development of the European Union (EU), the respective national regulations were gradually harmonized with Community law. Finally, in the year 1994, almost all customs regulations of the Community were integrated into a single act, the Community Customs Code. Together with its implementing provisions, the Customs Code provides the basic framework of European customs law. Community law is now supplemented by national regulations only in the individual case.

1.2 Sources of Law and Legal Foundations in International Law

With the Community Customs Code (Council Regulation (EEC) 2913/92), in force as of January 1, 1994, and its implementing provisions (Commission Regulation (EEC) 2454/93), common customs law with immediate legal force in all EU member states was created.

Because of the primacy of Community law, there was no need for the German Customs Act once the Community Customs Code had come into force. However, despite the comprehensive customs regulations of the EC, in certain cases national legal provisions are needed for closing gaps or providing supplementary regulation. The Customs Code leaves the regulation of particulars expressly to the member states. In Germany, the required national customs law has been framed in the Customs Administration Act (Zollverwaltungsgesetz) and its implementing provisions (Customs Regulations–Zollverordnung).

The sources of law for the assessment of customs duties by the Federal Republic of Germany therefore result from Community customs law, in particular:

- The Community Customs Code (CCC)
- The Customs Code Implementing Provisions (CCIP)
- Council Regulation (EEC) No. 918/83, setting up a Community system of relief from customs duty, and
- The European Communities' Common Customs Tariff

and German national customs law:

- The Customs Administration Act (Zollverwaltungsgesetz–ZollVG) of December 21, 1992, and
- Its implementing provisions (Zollverordnung–ZollV) of December 23, 1993

European customs law was considerably influenced by the rules of international law based on treaties and international agreements. The General Agreement on Tariffs and Trade (GATT), heralding a new era of international trade in the aftermath of the Second World War, has had the most substantial impact on German and European foreign trade law, and on foreign trade law worldwide. The GATT, established in 1947, aims for free international trade and seeks to achieve this goal primarily by the abolishment of all tariff and non-tariff trade barriers. The Federal Republic of Germany joined the GATT in 1951. The GATT would eventually evolve into the World Trade Organization (WTO), now listing close to 150 member states.

1.3 Purview of European Customs Law

The purview of European customs law is basically the Community's customs territory. As of now, the following 27 countries are EU member states (in sequence of the date of accession): Belgium, Germany, France, Italy, Luxembourg, the Netherlands, Denmark, Great Britain, Ireland, Greece, Portugal, Spain, Finland,

Austria, Sweden, Czechia, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, Slovakia, Bulgaria, and Romania.

Basically the customs territory corresponds with the member states' sovereign territories. However, historical, economic or geographic peculiarities lead to discrepancies with some member states. By the affiliation of certain non-continental or overseas areas to the customs territory, the Community, e.g. has an external border with Brazil in French Guyana. The Community's customs territory also includes territorial waters, up to 12 sea miles from the coastlines, and airspace within conventional airplane cruising altitude (Article 3 (3) CCC).

2 Basics of European Customs Law

2.1 General Information

The movement of goods within the European Community is not subjected to customs controls (free trade). Rather than import/export, the trade of goods within the European Community is referred to as intracommunity supply/acquisition.

The application of customs law is therefore limited to the trade between the Community and third countries. The right of the customs authorities to monitor compliance with the regulations and to intervene in the goods traffic if necessary results from the principle of customs supervision. With the entry into the Community customs territory, goods are automatically subjected to the phase of customs supervision which ends only after the completion of customs treatment. Customs supervision of the goods traffic particularly provides the assurance of the assessment of import and export duties as well as compliance with the regulations of customs law and the import prohibitions and restrictions.

Subject to customs supervision is the traffic of all goods which enter or leave the Community's customs territory by sea or air or land, or across the borders of the free zones, as well as the traffic of goods liable to consumption tax beyond the territory of German consumption tax assessment. Therefore the movement of alcoholic beverages, tobacco products, or mineral oil is subject to customs supervision even with regard to intracommunity trade.

The application of customs regulations starts with the trade of goods. The term "goods" is not defined by the Community Customs Code. According to the European Commission's interpretation, the term includes all goods which can be classified by the customs tariff. Goods within the meaning of customs law may therefore be all movable and physically definable items which are controllable by human will. A special case is electricity, included in "goods" due to its characteristic as an item of trade. Gases and fluids take on the character of goods only by their containment in a receptacle or by transport through pipelines. Human beings and corpses as well as implants are not considered goods. However, human parts imported separately, e.g. donor kidneys or hearts for purposes of surgery, are regarded as goods.

2.2 *Customs Status of Goods*

Decisive for the customs treatment of goods in the EC is the distinction according to their customs status as either Community or non-community goods. As has been discussed, Community goods basically are left outside the sphere of customs law issues.

According to Article 4 no. 7 CCC, *Community goods* are those wholly obtained or manufactured in the customs territory of the Community under conditions defined in Article 23 CCC, without parts being added which have been imported from countries or territories outside the Community's customs territory. Goods obtained or manufactured outside the Community's customs territory, i.e. originating from a third country, are also considered Community goods if they have been properly released for free circulation inside the Community. Furthermore, goods obtained by processing Community goods as defined above are regarded as Community goods.

Accordingly, *non-community goods* are all goods which cannot be subsumed under one of the definitions for Community goods.

While traders, so-called economic operators, may basically traffic Community goods freely – without any involvement of the customs authorities, non-community goods may be handled only to the extent admitted by the customs authorities.

According to the territoriality principle, goods brought into the customs territory of the European Community initially receive the status of non-community goods. Insofar as the status of Community goods is determined in the course of customs examination, any further customs inspection is discontinued. Non-community goods, however, can keep, change, or lose their status.

Community goods which leave the community's customs territory lose their status as such and turn into non-community goods with crossing the external border.

2.3 *Amendments to the Community Customs Code in 2005*

Increasing globalization and changes in the international security situation have led the World Customs Organization (WCO) to create worldwide basic conditions for the customs authorities' modern and efficient risk management, with a "Framework of Standards to Secure and Facilitate Global Trade" (SAFE). With an amendment to the Community Customs Code by Regulation (EC) No. 648/2005 of April 13, 2005, the European Union has adopted these aspects of security policy and framed them into Community law. For the time being, only parts of the amended Customs Code have come into force as of May 11, 2005.

The amendments are based on the realization that – due not least to the recent phenomenon of international terrorism – cross-border trade must be monitored more effectively. For this purpose, risk analyses shall be conducted throughout the entire European Community on the basis of a standard risk management system. Said analyses do not only concern the goods themselves and the possible hazards resulting

from them; they are also intended to help prevent threats to the member states and the Community's citizens, especially by collecting information about the context of the transfer of goods. This requires above all things a functional system for the electronic data exchange between the EC member states. In order to carry out the risk analyses effectively, the required data must be made available to the customs offices of entry in due time before the goods enter the Community's customs territory. According to Article 36a CCC, a so-called summary declaration must be delivered before the goods' entry, operative from July 1, 2009, as a basic rule.

Another substantial element of this legislative initiative for improved security is the introduction of the status of the so-called authorized economic operator.

2.4 Authorized Economic Operator

In the course of the ongoing reform of the customs law of the European Union, enterprises residing in the European Union and participating in cross-border trade may apply for the status of a so-called authorized economic operator (AEO) as of *January 1, 2008*. This status results in preferential treatment with regard to security and safety relevant customs controls and simplifications provided by customs regulations.

The goal is the assurance of an unbroken international supply chain, from the goods' manufacturer to the end consumer. Irrespective of the specific import and export transactions, enterprises are checked for their reliability in advance. If reliability is attested, the certified enterprises can be largely exempted from import and export controls from then on. For certain simplified procedures under customs law (e.g. entry in the records), meeting the respective conditions is assumed as they have been verified already before granting the AEO certificate.

The AEO certificate is recognized by all member states and considered a distinction of quality appealing to customers and business partners. It is valid throughout the European Union and not limited in time. Therefore it takes only one authorization procedure for the entire customs territory of the European Community.

The status is granted upon application which, according to Article 14d CCIP, must be submitted to the customs authorities of that member state where the applicant keeps its main accounts, including the documents and records based upon which the customs authority is able to verify and monitor the conditions and criteria relevant to the AEO status. In Germany the proper agencies are the main customs offices. Information on form and content of the application is contained in Article 14c CCIP.

The conditions for granting the status are established by Article 5a CCC read in conjunction with Article 14a et seq. CCIP, supplemented by directives drawn up specifically for the AEO. The AEO status may be granted only to persons who have a reputation for observing the customs regulations, maintain a satisfactory system of keeping their account books and transport records which enables appropriate customs controls, and provide financial solvency and the fulfillment of certain

security and safety standards. In checking these criteria, the customs authorities may draw on the information furnished by external experts (e.g. bank information with regard to solvency, accountant expertise on the applicant's accounting system).

2.5 Trade Recording/Entry of Goods into EC Customs Territory

According to Article 37 CCC, goods brought into the customs territory of the Community are subject to customs supervision from the time they cross the external border. The same applies to goods surfacing at German customs offices outside the EC customs territory, according to Article 38 (3) CCC. The required German sovereignty on third-country territory finds its justification in various international treaties.

2.5.1 Summary Declaration in Advance

As a result of the 2005 reform of the Community Customs Code, customs supervision begins even before the goods' entry with the summary declaration, to be delivered in advance (Article 36a CCC). This instrument is intended to make a risk analysis possible even before the goods are physically brought into the customs territory. The same applies to goods leaving the territory. The provisions on the pre-arrival/departure summary declaration will come into force as of *July 1, 2009*.

The summary declaration must basically be lodged at the customs office of entry by way of electronic data transmission. Only in exceptional cases may the declaration be turned in as a hard copy document. It must include a data set on the grounds of which an adequate risk analysis is possible. As a basic principle, the declaration must be available to the customs office in sufficient time prior to the goods' actual entry in order to allow for a risk analysis in advance. Depending on the mode of transport, Articles 184a through 184c CCIP provide for different time targets. The shortest conceivable period would be 1 h lead time for truck cargo in highway traffic.

If no summary declaration has been lodged prior to the goods' entry, the trader must turn in the declaration immediately after the goods' presentation to customs. In the cases defined by the catalog of Article 181c CCIP no entry summary declaration is required.

2.5.2 Conveyance Obligation/Presentation

According to Article 38 CCC, goods brought into the Community's customs territory must be conveyed to the customs offices or to other places or free zones designated by the customs authorities via specified routes (customs routes) without

delay. There the goods must be presented to customs by the person who has brought the goods into the territory or who assumes responsibility for their carriage after entry (Article 40 CCC). The *presentation* is the customs office's notification that the goods are at their designated place. The presentation can be executed in writing, orally, or by conclusive action, e.g. by handing over the transport documents. The notification of the presentation must be completed by the lodging of a summary declaration if applicable.

To allow effective customs supervision, goods may only be brought into and out of the European Community's customs territory on certain traffic routes. Thus the flow of goods is channeled. Truck highway traffic and waterway traffic are directed to certain customs routes. Maritime traffic commits cargo ships to certain customs berths; air traffic commits aircraft to certain airports of entry.

After bringing goods into the EC customs territory, the trader may not deal with the goods as he or she pleases anymore. Their customs status – community goods or non-community goods – is of no significance here. The customs office must rather be enabled to determine the goods' customs status.

The provisions of Article 38 CCC do not apply to goods on board of vessels or aircraft crossing member states' sea territory or airspace without disembarking on Community territory.

After their presentation to customs, the goods are subject to customs supervision according to Article 37 (1) CCC and may be subjected to customs controls. For examining status and presentation, German law provides for the so-called "*Überholung*" (customs inspection). The inspection does not concern the specific quantity and nature of the goods (these statements are reserved for examination within the context of placing the goods under a customs procedure) but rather focuses on the means of transport, containers, and packaging. The *Überholung* is meant to establish if non-community goods have been imported and if all goods imported have been properly presented to customs. *Überholung* is an instrument for discovering non-community goods intended for entry past customs supervision, purposefully concealed in means of transport or packages, and therefore it particularly helps combat smuggling, liable to prosecution in Germany in accordance with Section 370 General Tax Code (*Abgabenordnung*), and infringement of customs law ("*Bannbruch*"), a criminal offense according to Section 372 General Tax Code.

2.5.3 Temporary Storage/Summary Declaration

Subsequent to their presentation, non-community goods brought into the customs territory of the Community must be assigned a customs-approved treatment or use within certain time periods. This may occur immediately after the presentation by the delivery of an according customs declaration. Which customs treatment or use will be assigned to the goods is for the economic operator to decide. However, it is not always clear from the outset under which customs procedure the goods will be placed.

For the decision which customs-approved treatment or use will be assigned to the goods, the customs authorities usually set a time limit of *45 days for maritime*

traffic and 20 days for all other modes of transport (Article 48, 49 CCC). After deadline the presented non-community goods must be transferred to a proper treatment or use. Until then they maintain the legal status of goods in temporary storage (Article 50 CCC). Temporarily stored goods may be kept only in designated places and may not undergo changes of any kind. The storage conditions laid down by the customs authorities must be observed. This regulation serves the goods' customs supervision in making sure that the customs authorities are always informed about the place and conditions of temporary storage so that they are able to execute customs controls if indicated. Because of limited storage space, storage at the customs office will only come into consideration in exceptional cases. Usually the premises of the person who has turned in the summary declaration will be designated as the place of storage. If the presented goods are transferred for storage to an uninvolved third party (e.g. a warehouse operation, a refrigerated storage building, or an airport enterprise), the customs authority enters into a custody agreement with said third party. The storage costs incurred must be paid by the person for whose benefit the storage is arranged.

The customs office monitors compliance with the above-mentioned time limits based on the *summary declaration*. Thus a summary declaration is always necessary if the goods are not assigned a customs-approved treatment or use immediately.

The summary declaration refers to the goods themselves and must comply with certain demands on its content, thereby exceeding the significance of the presentation. In contrast to the customs declaration, it does not include all the information required for placing the goods under a specific customs procedure. Mandatory disclosures are among others the mode of transport, the goods' packaging, and the kind of goods and their quantity in order to enable the customs authority to get a general idea of the goods presented. In particular the kind of goods is to be indicated precisely, allowing a comparison with the disclosures in the customs declaration delivered at a later point in time.

According to Article 43 CCC, the summary declaration must be lodged as soon as the goods have been presented. The declaration shall be made on an official form or by electronic data transmission. Summary declarations can also be submitted in the shape of the cargo manifest or the air waybill (AWB) in air transport and in the shape of the cargo declaration in maritime traffic.

2.6 Choice of Customs-Approved Treatment or Use/Customs Procedures

Subsequent to their presentation to customs and the lodging of the summary declaration, non-community goods brought into the Community's customs territory enter into another stage regulated by customs law. The economic operator basically has the choice which customs-approved treatment or use will be assigned to the imported goods. Article 4 no. 15 CCC stipulates comprehensively and conclusively which treatment or use may be assigned to goods. The customs authorities are not

authorized to make their own choice and assign one of the options themselves. However, the economic operator's right to choose can be limited, either by prohibitions and restrictions regarding cross-border trade or by trade policy measures (e.g. foreign trade import and export restrictions).

Article 4 no. 15 CCC provides the following options for the goods' *customs-approved treatment or use*:

- Placing the goods under a customs procedure
- Bringing the goods to a free zone or free warehouse
- Re-exporting the goods from the Community's customs territory
- Destroying the goods
- Abandoning the goods to the treasury

Obviously the choice of treatment or use corresponds with the purpose of the goods' import to the customs territory of the Community, among other factors. If the goods are meant to enter the economic cycle of the Community, they will be placed under the customs procedure "release for free circulation", and import duties are applied (usually customs duty and import value-added tax). If the goods are not (yet) intended to enter the Community's economic cycle but rather to be stored or finished and then re-exported from the Community's customs territory, they can be placed under one of the other defined customs procedures.

2.6.1 Placing Under a Customs Procedure

If the goods' chosen customs-approved treatment or use is their placing under a customs procedure, the following *customs procedures* come into consideration:

Release for Free Circulation

In order to allow the economic operator to deal with the goods imported from a third country at his or her discretion, they must be placed under the customs procedure "release for free circulation". Once released for free circulation according to Article 79 et seq. CCC, the non-community goods are assigned the status of Community goods, and hence treated as such. This is the customs procedure of choice primarily if the goods are meant to remain in the Community's customs territory and to enter the economic cycle in order to generate revenue. This usually implies payment of the applicable import duties (customs duty, import value-added tax, and special consumption tax if applicable). The placing of the goods under this customs procedure (the so-called customs clearance) is generally conducted by the inland customs offices to relieve the border customs offices and to handle the movement of goods across the Community borders as swiftly as possible. After the goods have been released, they are no longer under customs supervision and free to be dealt with. For example, car tires imported from the USA by a German wholesaler can be sold to the end consumer without further customs supervision once they have been released for free circulation.

However, there are exceptions to this basic rule: The goods usually remain under customs supervision after their placing if they have been released for free circulation under partial or total exemption from import duties because of their intended end use. Automobiles for instance may be released for free circulation under total exemption from import duties according to the Community's system of relief from import duties if imported on the occasion of marriage or emigration. In that case the assets may not be sold or otherwise committed to third parties before a deadline of 12 months is exceeded. Under certain conditions customs supervision will be in effect until the goods have been brought to their intended end use.

Transit

Import duties on goods imported to the customs territory of the Community for free circulation must basically be paid at the time of border crossing. Because the goods will most often not remain at the border location but are destined for a recipient in the interior, the customs procedure "transit" makes it possible to clear the goods at the place of their end destination.

The relocation of customs clearance from the external border to the interior offers several advantages to both the economic operators and the customs authorities involved.

If the goods are cleared close by the operator's premises, the recipient is able to examine the goods and to establish whether they meet his requirements or show damages. And the relocation of the time-consuming clearance measures gives relief to the border customs offices, letting traffic flow faster.

Transit is also the procedure of choice if the goods are intended not to remain in the Community's customs territory, but for (re-)exportation or indeed merely for transit.

Under the transit procedure, goods are moved *duty unpaid*, i.e. under suspension of import duties which normally would have to be paid. This implies a certain contingency risk due to which the carriage is subject to customs supervision. In particular, security must be provided for the transit, and the goods must be presented or delivered in due time and unchanged at the place of destination so that no goods remain in the customs territory duty unpaid.

The customs authorities of the member states participating in the transit procedure have established a large number of customs offices at the regional focal points of commerce and industry in the interior (inland customs offices), providing customs services to the economic operators.

Customs Warehousing

Non-community goods can be placed under the "customs warehousing" procedure without involving import duties. The goods are stored at a customs warehouse and either re-exported at a later time (transit storage) or placed under another customs

procedure. Customs warehousing is based on the concept that the duty charge should be applied to goods only if they in fact participate in the Community's economic competition. Their mere existence in the economic territory is not sufficient for a participation in the internal market. The time of storage is not limited, making the conveyance to a customs warehouse a considerable option especially if the goods' end destination is not determined at the time of entry.

Inward Processing

Under the "inward processing" procedure, non-community goods are brought into the customs territory of the Community, processed here, and re-exported as so-called compensating products. The preferential tariff treatment is meant to improve the competitiveness of companies in the EC over third countries. Import duty relief for foreign goods to be processed or repaired in the EC is meant to make the sale of the processed or repaired goods to customers in third countries easier. The Customs Code provides for two different procedures to apply preferential treatment: Either no import duties are assessed in the first place or the primary products are released for free circulation subject to import duties to be reimbursed at the time of the compensating products' exportation.

Processing Under Customs Control

The procedure called "processing under customs control" also deals with processing imported goods in the customs territory of the Community, with the distinction that the processed goods are not intended for re-export. Here non-community goods are meant to enter free circulation only after a change of their nature, characteristics, condition, or value. Import duties are assessed with regard to the processed products. This procedure therefore makes economic sense only if the imported goods are transferred to a lower production stage through processing, so that the company will benefit from the lower tariff applicable. This will usually be the case with the recycling of returned goods.

Temporary Admission

Goods can be placed under the "temporary admission" procedure if they are not intended to permanently enter the Community's economic cycle but to be used only for a limited amount of time and to be re-exported unchanged after their temporary use. The deciding factors for the scope of the preferential treatment are the kind of goods, their specific use, and the actual time of use. Even a total exemption from import duties is possible. Examples are the temporary use of means of transport, professional equipment, personal belongings, product samples for trade fairs, and sports equipment.

If none of the statutory and conclusive definitions of total exemption is fulfilled, partial relief may be granted. Thus allowance is made for the fact that temporarily used goods such as machines have participated in the economic cycle for a certain time and thus have competed with products of manufacturers residing in the European Community. According to Article 143 CCC, import duties payable for goods placed under temporary admission with partial relief from import duties amount to 3% every month or fraction of a month of the import duties which would have to be paid if the goods had been released for free circulation.

Outward Processing

Under the “outward processing” procedure, Community goods are temporarily exported and re-imported to the community’s customs territory after having been processed in a third country. The goods to be processed originate from the Community’s free circulation. After re-import, the goods processed in a third country are released for free circulation with total or partial relief from import duties. This makes it possible to make use of lower labor costs in third countries. As in the case of inward processing, relief can be granted either by way of the differential method or the value-added method. According to the differential method, import duties are determined for the compensating products first. The resulting amount is then reduced by the fictional import duties for the exported primary products. The value-added method provides tariff treatment on the basis of the processing or repair costs while the primary products are left unconsidered. However, with the temporary export possible export duties are imposed as well, as there is no obligation for re-importation and the goods may ultimately leave the customs territory of the community.

Exportation

The export of Community goods is subject to the supervised “exportation” procedure in accordance with Article 161 CCC. The customs office responsible for the location of the exporter’s premises, the so-called customs office of export, verifies the admissibility of exportation and assesses export duties if applicable. The actual exportation of the goods from the customs territory takes place via the so-called customs office of exit, at the Community’s external border or at an airport. As practically no export duties are imposed by the European Union—with the exception of agricultural duties, the exportation procedure is set up primarily to supervise compliance with export prohibitions and restrictions as well as trade policy instruments.

2.6.2 Customs Procedures with Economic Impact

Placing goods under a so-called “customs procedure with economic impact” involves special *authorization*. The following customs procedures require the customs

authorities' authorization: customs warehousing, inward processing, processing under customs control, temporary admission, and outward processing.

The standard authorization procedure for all customs procedures with economic impact finds its legal foundation in Articles 497 through 523 CCIP. Authorization is granted only if the economic operator offers every necessary guarantee for the proper conduct of the operations and if the customs authorities can guarantee that supervision and customs examination do not entail an administrative effort which would be economically disproportionate. The rules of procedure for the individual customs procedures contain additional authorization requirements. However, the authorization procedure has been liberalized considerably in the course of the latest legal reform. In particular with regard to inward and outward processing as well as processing under customs control, the requirements for admission have been eased for the Community industry's benefit. Articles 539, 552, and 585 CCIP define, for instance, in which cases the economic requirements are assumed to be fulfilled. Only if none of the cases of legal fiction applies, the directives for examination of Article 502 CCIP are applicable, providing their own criteria for inward processing, processing under customs control and outward processing, such as the primary products' unavailability in the Community, significant price differences, or contractual obligations.

In contrast to the customs procedures with economic impact, no authorization procedure applies to the release for free circulation, the paramount customs-approved treatment. Neither do transit and exportation procedures require the customs authorities' authorization.

2.6.3 Other Customs-Approved Treatment or Use

Entry into Free Zones or Warehouses

Another customs-approved treatment apart from placing goods under a customs procedure is bringing them to a free zone or free warehouse. Free zones and warehouses are used primarily for storing and handling cargo intended for foreign trade. International transfer of goods is meant to be interfered with as little as possible by customs formalities. Import duties are basically assessed only at the time goods actually enter the internal market's economic cycle, leaving a positive effect on the importers' liquidity.

Free zones as well as free warehouses are part of the Community's customs territory (Article 166 CCC), yet separated from the rest of the territory. With regard to the assessment of duties and the application of trade policy instruments, non-community goods inside free zones or warehouses are considered not yet inside the customs territory. In contrast to free warehouses which can be made up by a single building or part of a building, free zones extend over an area of land. So far only free zones have been established in Germany; there are no free warehouses in this country. As domestic free zones are exclusively parts of harbors they are traditionally referred to as "free ports" (Freihäfen). Germany provides the following free

zones: Freihafen Bremen, Freihafen Bremerhaven, Freihafen Cuxhaven, Freihafen Deggendorf, Freihafen Duisburg, Freihafen Emden, Freihafen Hamburg, and Freihafen Kiel.

According to the kind of supervision provided, two types of free zones can be distinguished:

Free zones of control type I are fenced in. The exchange of goods with the regular customs territory is possible only via entries and exits controlled by the customs authorities. Even passenger traffic flowing through free zones must adhere to designated passageways.

Control type II free zones are not fenced in and can therefore be entered and left unhindered. Customs formalities, customs supervision, and the assessment of customs debts correspond with the conditions of customs warehousing.

In control type I free zones, non-community goods must be assigned customs-approved treatment or use only at the time they are brought into the regular customs territory or re-exported after storage. Special provisions apply to goods subject to certain prohibitions and restrictions, e.g. in accordance with narcotics law. Basically no presentation or declaration obligations apply for seagoing vessels if they come from the sea and take a customs route into a control type I free zone. Neither vessel nor onboard cargo is subject to customs clearance. This is different for inland free ports which can only be reached by way of the transit procedure. For control type II free zones as well, the physical placing of goods is not sufficient. If goods are intended to be brought into free zones of this control type, they must be presented and declared.

Re-Exportation from the Community's Customs Territory

Re-exportation applies when non-community goods are properly brought out of the customs territory of the European Community again. Customs supervision makes sure that the goods do not enter the economic cycle anyway and that there are no violations of the export prohibitions and restrictions to be observed. If re-exportation follows either customs warehousing, inward processing, processing under customs control, or temporary admission, the provisions for the exportation customs procedure apply to re-exportation as well, with the consequence that a customs declaration must be lodged.

Other Treatment or Use

If the economic operator decides on the destruction of the goods within the framework of customs-approved treatment or use, the treasury must not be committed to bearing any of the costs involved.

According to the Community Customs Code, the economic operator may also abandon the goods in favor of the treasury. This option is not a binding provision for the entire Community but requires the member states' adoption in their national regulations. In Germany no abandonment of goods to the treasury is allowed.

2.7 *Customs Declaration*

Goods to be placed under a *customs procedure* must be covered by a customs declaration for the chosen customs procedure (Article 59 (1) CCC). The declaration must contain all characteristics and circumstances of relevance to the specific customs procedure and tariff treatment. In addition, all necessary documents (e.g. invoices and transport documents) must be included. The so-called declarant in whose name the customs declaration is made bears its legal consequences.

2.7.1 **Form and Content of the Customs Declaration**

As a basic rule, placing goods under the desired customs procedure must be applied for in writing by use of a special form (the so-called single administrative document, or SAD). Customs formalities may also be handled by means of electronic data processing (the so-called IT operation “ATLAS”). In certain cases of inferior economic relevance, the declaration may be delivered orally or by conclusive action (e.g. the declaration of souvenirs).

Apart from the customs declaration via data processing, the declaration in writing is the form of greatest importance to commercial trade. It must be made on the official form and must bear a signature. The customs declaration must include comprehensive information about the goods, particularly the goods’ identity (identification and quantity), their origin (country of dispatch), value (invoice amount, statistical value, customs value), and the corresponding business transaction (kind of transaction, persons involved). In order to record this amount of information in the SAD in concise form and translatable for all EC member states, most mandatory disclosures must be entered encoded. The code is defined for all EC member states in the Annexes 37, 38 to the CCIP.

According to the specific customs procedure, different documents must be included with the declaration. They can be necessary, e.g. to determine the goods’ value, origin or identity, or the amount of duties, or to resolve doubt with regard to possible prohibitions and restrictions. Which documents are required in the individual case can be derived from Articles 218 et seq. CCIP.

2.7.2 **Simplified Customs Declaration**

If an economic operator regularly delivers a large number of customs declarations, he or she becomes eligible for simplified procedures. The simplified initial customs declaration does not have to include all the required particulars. Missing particulars may be turned in at a later time in a single supplementary declaration. The economic operator requires an authorization granted by the customs authorities to benefit from some of the simplified formalities. It must be applied for at the main customs office responsible for the location where the applicant’s accounts are kept for the most part. Authorization is granted only

if certain conditions are met. Only those economic operators are eligible who frequently import goods to the customs territory of the European Community and who have not committed serious or repeated offenses against customs regulations.

The following possible simplifications (Article 76 CCC) can be made use of basically for all forms of customs declarations.

Incomplete Declaration

The goods are placed under the customs procedure of choice by lodging a customs declaration which does not contain all the required particulars or include all the required documents. Missing particulars or documents (e.g. invoices, freight charge verification) must be submitted within a month's time. Import duties are assessed at the time of customs clearance. No authorization is required.

The necessary minimum disclosures are listed in Article 254 CCIP. As of *July 1, 2009* Article 254 CCIP will be revised and the required minimum disclosures for a proper incomplete declaration will be redefined. At the time of customs clearance, at least those documents must be available on whose submission the placing under the respective customs procedure depends (e.g. import licenses).

Simplified Declaration Procedure

In contrast to the incomplete declaration, the supplementary declaration does not have to be lodged separately for each incomplete declaration lacking particulars and/or documents. Rather particulars or documents missing in a sequence of simplified declarations are subsequently filed periodically in the form of just one supplementary declaration. Only then import duties are assessed. This procedure requires the previous authorization by the proper main customs office.

Entry Procedure

The goods are not presented at the customs office but rather on the recipient's or declarant's premises and placed under the specific customs procedure by entry in the records. Notification of the customs office is mandatory (electronically or in writing), informing customs that the goods have been received and entered in the records. By entry in the records formalities involved in the delivery of a customs declaration do not apply at the time of customs clearance. The recipient/declarant commits himself to turn in a summarized supplementary customs declaration for goods imported and entered in a certain period of time. Import duties are assessed after submission of the supplementary declaration. This procedure requires the previous authorization by the proper main customs office.

2.8 Duties on Cross-Border Trade

2.8.1 General Notes

The emphasis of import and export duties is on customs duties. These are duties connected mostly either to the goods’ entry into the economic cycle (import customs duty) or their exit from the economic cycle (export customs duty). In addition there are customs duties as a result of breaches of regulations.

Article 4 no. 10 CCC includes in *import duties* customs duties and charges of equivalent effect as well as agricultural duties on imported goods. Equivalent charges are those connected to border crossing, thus making particularly imported goods more expensive without affecting prices of similar EC goods (e.g. import license fees).

According to Article 4 no. 11 CCC, *export duties* include customs duties and charges of equivalent effect as well as agricultural duties on exported goods. As virtually no export duties are raised by the European Union, customs duties basically originate only in connection with the importation of goods. There are some exceptions in agriculture, however, e.g. for the exportation of soft wheat and durum wheat.

National duties such as the import value-added tax and special consumption taxes imposed on beer, spirits, sparkling wine, natural gas, coffee, mineral oil, electricity, and tobacco are not customs duties. They are intended to adjust the prices of foreign goods to those of domestic products.

The importation of goods to Germany from third countries can thus be subject to the following import duties:

EC duties	National duties	
– Customs duties and equivalent charges, e.g. antidumping and countervailing duties	Import value-added tax	Special consumption tax on: – Energy products – Spirits and spirit products
– Agricultural charges, e.g. agricultural duties, reduced agricultural components, additional agricultural duties		– So-called alcopops – Tobacco products – Coffee – Beer – Sparkling wine and intermediate products – Electricity

The amount of the duties applied can be determined on the basis of the electronic customs tariff (elektronischer Zolltarif – EZT). The German customs administration has provided the EZT on the Internet since January 1, 2006 (as “EZT-online”). The EZT includes the data of the TARIC (Tarif Intégré des Communautés Européennes), the uniform customs tariff of the European Community, supplemented by national data, i.e. import value-added tax and consumption tax. In order to provide for a smooth and standardized customs clearance procedure for imported goods, all goods and commodities are recorded in a systematically structured, classified index of goods (so-called nomenclature). The classification is made by encoding the

goods' description into an 11 digit code number. In addition to the import duty tariff, other legal consequences connected to cross-border trade can be determined on the basis of this code number as well, e.g. if possible prohibitions and restrictions must be observed, if importation or exportation requires licensing, if the further customs-approved treatment or use is subject to the submission of additional documents, and so forth.

2.8.2 Customs Value

In times of the ever-increasing impact of globalization, companies participating in international trade expect uniform regulations worldwide. Customs tariff law has been harmonized internationally already to a large extent. The central document is the so-called GATT (General Agreement on Tariffs and Trade) Customs Valuation Code on the basis of which the customs value is determined.

According to the GATT Customs Valuation Code, determination begins with the price for which the goods to be valued have been actually sold, i.e. the imported goods' so-called transaction value. In order to cover all conceivable cases of international trade, there are five more methods for finding the specific customs value besides the transaction value method, each to be applied if the respective preferential method fails.

According to the GATT Customs Valuation Code, the customs value is either

1. The transaction value of the imported goods, or
2. The transaction value of identical goods, or
3. The transaction value of similar goods, or
4. A selling price in the country of importation adjusted in accordance with certain criteria (so-called "deductive method"), or
5. A value calculated on the basis of the manufacturing costs, or
6. A value estimated according to the so-called "fall-back method"

The stipulations of the GATT Customs Valuation Code have been transposed to European customs law in the Articles 28 through 36 CCC.

2.8.3 Formalities of Customs Value Declaration

If an economic operator wants to have goods released for free circulation, for instance, he or she must include a declaration of particulars relating to the customs value with the customs declaration in writing and by use of the required form. All the information required for determining the customs value must be furnished. In exceptional cases the customs authorities may waive the declaration of customs value, e.g. if the customs value of the goods imported does not exceed 10,000 euros per shipment, for importation of no commercial nature (e.g. goods imported within the context of tourist travel), or for the importation of third-country goods labeled duty-free according to preference regulation.

In practice the purchaser of the imported goods usually provides the particulars relating to their customs value. However, not every individual can act as a customs value declarant. As a basic rule, the declarant must be a person who resides in the Community; this is meant to guarantee that the declarant will be available for examination and/or can be held responsible if, e.g. the particulars turn out to be incorrect. The individual must also be able to substantiate all the information provided with the declaration of customs value and must be in possession of the corresponding documents. The customs value declarant assumes full responsibility for the correctness and completeness of the particulars contained in the declaration and for the authenticity of the documents presented for verification.

The particulars delivered with the declaration of customs value must be verified with corresponding documents. Among the documents required are in particular copies of the invoice or the contract of sale as central verification of the purchase price paid or payable. Furthermore all supporting documents which result in an adjustment of the purchase price by either addition or reduction in accordance with the Community Customs Code must be included with the declaration of customs value. This particularly applies to documents on the costs of transportation (e.g. the waybill).

If the customs declaration is made to the customs office online, the submission of documents is largely waived. However, the original documents specified above must be held at the declarant's business enterprise at the time of the customs value particulars' submission and must be presented to the customs office for inspection upon request.

2.8.4 Customs Debt

A customs debt is only incurred with respect to goods liable to duties, i.e. the Community Customs Code must stipulate customs duties or other import duties at the given time.

For the European Community customs duties are essentially instruments for the regulation of economic activities. Goods imported from third countries usually enter into immediate competition with products originating from within the European Community. Because of often more competitive manufacturing costs abroad, comparable domestic goods would not be marketable without intervention. The imposition of customs duties therefore serves the artificial price increase of cheap foreign goods, among other aspects. The full amount of realized customs duties benefits the budget of the European Community.

Goods which can be released for free circulation within the framework of non-tariff relief from customs duties (e.g. returned goods or cases treated in the Community system of relief) or preferential tariff measures are not liable to import duties. Goods are liable to import duties if the tariff system provides for customs duties or agricultural duties and no non-tariff relief from duties applies in the individual case.

The facts and circumstances which create a customs debt, i.e. the customs debtor's obligation to pay import duties, are established in detail in the Community Customs Code. Usually a customs debt is incurred if non-Community goods liable to import duties are released for free circulation. A customs debt is also incurred in cases of breaches of regulations.

Cases of Customs Debt

- *Release for free circulation, Article 201 (1a) CCC*

This case always presupposes the correct release of goods for free circulation, i.e. their presentation, the submission of a customs declaration, and compliance with all other obligations pertaining to the specific procedure.

- *Placing under temporary admission with partial relief from import duties, Article 201 (1b) CCC*

This clause presupposes the proper placing of the goods under the temporary admission procedure.

- *Unlawful introduction, Article 202 CCC*

The clause covers unlawful action from the time of the actual border crossing up to the presentation of the non-Community goods at the proper border customs office. This applies to the entry of goods from third countries as well as from free zones or free warehouses.

- *Unlawful removal of goods from customs supervision, Article 203 CCC*

Non-community goods recorded by customs authorities and placed under temporary storage or under a customs procedure are subject to customs supervision (with the exception of release for free circulation). If goods are removed from the authorities' supervision, e.g. by unauthorized relocation or consumption, so that the goods can no longer be examined, the situation is classified as unlawful removal, resulting in a customs debt.

- *Non-fulfillment of obligations under customs law, Article 204 (1a) CCC*

A customs debt is also incurred from breaches of obligations which result from the utilization of temporary storage or a customs procedure. Especially the exceeding of deadlines, unapproved treatment or use of goods, and non-fulfillment of formalities may lead to a customs debt in accordance with Article 204 (1a) CCC.

- *Non-compliance with conditions of customs procedure or special treatment according to the goods' intended end use, Article 204 (1b) CCC*

This legal clause includes missing conditions required for placing goods under the respective customs procedure. Among these cases are placing goods under

inward processing after expiration of the authorization's period of validity and exceeding the particulars of quantity and value as established in the authorization.

- *Consumption, disappearance and unlawful use of goods in control type I free zones, Article 205 CCC*

An import customs debt is also incurred if goods liable to import duties are consumed or used inside a free zone under conditions not provided by customs law.

As a basic rule a customs debt can be assessed to imported goods only once. If the provisions of several clauses for the emergence of customs debts are met, the chronologically first pertinent clause will be decisive.

Goods Liable to Import Duties/Amount of Import Duties

Releasing non-community goods' for free circulation usually pursues the objective of assigning them the status of Community goods. For this purpose lawful import duties must be imposed on all goods as far as no tariff or non-tariff preferential treatment is provided. Import duties are made up of customs duties and import value-added tax as well as, if applicable, special consumption tax, e.g. on tobacco products, mineral oil, etc.

Goods are liable to import duties if the customs tariff of the European Community provides for customs duties or other import charges of the EC at the given time (Article 20 (1) CCC). The relevant time for a customs debt on importation to be incurred is the time the customs declaration is received by the customs office. Debtor, i.e. committed to the payment of import duties, is the declarant according to Article 201 (3) CCC.

For the release of goods for free circulation, the deciding base values are those existing at the time the customs debt is incurred. The base values for assessment are principally the goods' quantity, nature, customs value, and the rate of duty, to be found in the electronic customs tariff. The total amount of the import duties owed according to law is based on the conventional rates of duty as provided by the customs tariff of the European Community (third-country duty rate). Yet another element of EC trade policy towards third countries is the granting of preferential tariff measures. These measures come in the shape of reduced duty rates up to total relief from customs duties for goods of preferential status and are regulated by the customs tariff of the EC as well. Preferential tariff measures are meant to contribute to abolish trade barriers and to promote international trade. For granting a possible preferential duty rate, the customs office examines if a special duty rate is provided for the goods in question according to the customs tariff of the Community, the granting of preferential tariff treatment has been applied for, valid preference verification has been submitted, and immediate carriage of the goods has been given proof of.

According to Section 11 (1) Value-Added Tax Act (Umsatzsteuergesetz), the basis for determining the import value-added tax is the customs value. To this

amount the amount of duty and special consumption tax, if applicable, must be added, as well as transportation costs for the goods' carriage from the EC border to their first destination in the territory of the European Community. First place of destination in EC territory is where the cross-border movement of goods ends. The standard tax rate is 19% of the value base, reduced to 7% for certain goods (particularly food, books, newspapers, and objects of art).

The following formula is applied for the determination of import duties (excluding consumption tax):

$$\begin{aligned}
 & \text{Customs value} \times \text{duty rate} = \text{amount of duty} \\
 & + \\
 & \text{amount of duty} \\
 & + \\
 & \text{transportation costs (from EC border to first place of destination)} \\
 \hline
 & = \text{import value-added tax value} \times \text{import value-added tax rate} \\
 & = \text{amount of import value-added tax} \\
 & = \text{amount of import duties}
 \end{aligned}$$

If the goods are liable to special consumption tax, the specific consumption tax must also be determined by consulting the pertinent acts on consumption tax.

Tariff and Non-Tariff Exemption from Customs Duty

Non-community goods imported from third countries basically become Community goods only after their release for free circulation in the EC and the assessment and payment of duties. Exceptions apply for certain goods which are subject to relief from customs duties (preferential treatment). The change of status then takes place without the assessment of duties.

European customs law distinguishes between two different kinds of relief from customs duties: tariff and non-tariff exemption. Both kinds of preferential treatment are based on the condition that goods are released for free circulation.

Tariff exemption from duties results directly from the customs tariff. For certain goods it determines the applicable duty rate as "free". However, national import duties, i.e. import value-added tax and special consumption tax if applicable are not concerned by the goods' exemption from duties and are incurred to the lawful amount.

Non-tariff exemption from duties concerns goods to which specific duty rates are to be applied, not preferred by tariff exemption from duties. Yet under certain conditions those goods can be left exempt from duties as well. The conditions are defined in various provisions of law, oriented primarily towards the goods' intended use. If non-tariff preferential treatment is granted, national import duties – import value-added tax, consumption tax – are dropped as well.

The statutory basis of non-tariff exemption from duties is made up in part by Community customs law, namely the Customs Code, the Customs Code's

Implementing Provisions, and the Council Regulation setting up the Community's duty relief system. Other legal sources are found in national customs law, i.e. the Customs Administration Act and its implementing provisions. Grounds for exemption from national import duties are established in the Import Value-Added Tax Relief Provision (Einfuhrumsatzsteuer-Befreiungsverordnung) and the Import Consumption Tax Relief Provision (Einfuhrverbrauchssteuer-Befreiungsverordnung).

Favorable tariff treatment can be claimed only if a customs debt is incurred in accordance with Article 201 (1) CCC. If a customs debt is incurred on the basis of a non-fulfillment of an obligation under customs law (i.e. according to Articles 202 through 205 CCC), preferential treatment usually cannot be granted. Only in exceptional cases (if conditions stipulated by Article 239 CCC and Article 900 (1o) CCIP are met) import duties can be reimbursed or abated.

Non-tariff exemption could originally also be claimed only in cases of customs debts incurred according to Article 201 (1) CCC (e.g. goods imported on the occasion of emigration covered by the duty relief system, personal belongings of travelers). Article 212a CCC, introduced as of January 1, 1997, has extended the application of favorable treatment to customs debts incurred according to Articles 202 through 205 CCC as well. Preferential treatment cannot be granted only if the economic operator has acted with fraudulent intent or obvious negligence.

Extinction of Customs Debt

A customs debt incurred, i.e. the customs debtor's obligation to pay import duties, can expire only if the amount of duty has been paid or remitted, if the customs declaration has been declared invalid, the goods' destruction or irretrievable loss, and by their seizure and subsequent confiscation (Article 233 CCC).

After a period of 3 years from the time the customs debt has been incurred, the assertion of the duty claim by the customs authorities is prohibited (Article 221 (3) CCC). Criminal offenses extend the limitation period to 10 years according to national law (Article 221 (4) CCC read in conjunction with Section 169 (2) sentence 2 General Tax Code (Abgabenordnung).

2.8.5 Import Prohibitions and Restrictions

Legal import, export and transit prohibitions are intended to safeguard significant objects of legal protection. A comprehensive listing of prohibitions and restrictions is hardly possible because of their diversity. However, four classes can be defined under which the individual prohibitions and restrictions can be grouped:

1. Protection of public decency, safety and order (e.g. military weapons, counterfeit money)

2. Protection of the health and lives of humans, animals and plants (e.g. protection of species, protection against epidemics)
3. Protection of national cultural assets of artistic, historical or archaeological value, and
4. Protection of industrial and commercial property (e.g. against trademark or copyright infringement)

Liability of the State

M. Luber

1 Introduction

Anytime a business is set up in Germany governmental supervision is involved, which ranges from certain obligations to provide notification of the commencement of operations to the fulfillment of specific permit requirements beforehand. On the other hand, the state's ability to influence business activity this way also entails a considerable amount of liability risk. The numerous legal regulations in existence give rise to enormous potential for error, even to state institutions. Enormous damages can be sustained as a result of an unreasonable delay in the commencement of a business operation caused by wrongful supervisory acts or omissions. The state is liable for such damages.

2 Overview of State Liability Law

State liability is generally understood as the liability of the state and other public bodies for damages that are sustained in the course of performing official duties. A distinction can be made between two basic types of liability: liability of the state for a wrongful act of state and compensation for disadvantages incurred through the lawful exercise of state authority.

The liability of the state towards its citizens for wrongful acts of state is an essential characteristic of a constitutional state, or a state governed by law and order. State liability supplements the principle of the lawfulness of the administration (Article 20, Section 3 of the German Constitution [GG]) and the guarantee of legal protection contained in Article 19, Section 4 of the Constitution (GG). The classic form of state liability for unlawfulness is regulated by paragraph 839 of the German Civil Code (BGB) in conjunction with Article 34 of the Constitution (GG). It derives from the unlawful and negligent behavior of a civil servant in the performance of his official duties and provides for monetary damage compensation.

The second pillar of liability for unlawful acts is comprised of the damages sustained by a party through the unlawful infringement of the state upon his property

rights (damage claim based on unlawful expropriation) or his immaterial rights (damage claim based on unlawful infringement of immaterial rights). As opposed to the liability of the state for unlawful acts, these damage claims do not require any fault or negligence on the part of the state.

The third pillar is comprised of provisions contained in various laws that provide the basis for special types of actions brought against the state, such as those based on strict-liability torts. In the new German states – with the exception of Berlin, Saxony and Saxony-Anhalt – the public liability law of the former German Democratic Republic, which was adapted as state law in more or less modified form, is still in force. It provides for no-fault liability.

The remaining liability gaps have been partially closed by case law and the judicial rulings that provide a legal basis for damage suits. Such judge-made laws deal primarily with liability for the breach of obligations stemming from “administrative law relationships under the law of obligations” and the right to remedial action guaranteed by public law.

State obligation to provide compensation, however, does not only exist in cases involving unlawful sovereign acts. If the state legally infringes upon the rights of an individual that are protected by law, then, as a general rule, the encumbrances resulting from such action are to be compensated for.

In the case of expropriation, Article 14, Section 3 of the Constitution (GG) provides for the payment of expropriation compensation. If the parties concerned are subjected to disadvantages as a result of a lawful act of state that do not amount to expropriation in the classical sense but still surpass the limit of what can be considered a reasonable sacrifice, compensation is to be made for the expropriating infringement.

The various laws in which claims against the state are anchored overlap and complement each other; in some cases they rule each other out. The law of state compensations does not exist as a closed and harmonious system but is more like “chaos with tradition.” Characteristically state liability law is a complex, barely coordinated and overlapping body of written and unwritten legal rules.

In addition, in state liability proceedings two legal worlds collide. In a civil process, issues relevant to administrative law are dealt with on the basis of civil-law liability standards. That naturally causes considerable difficulties on the level of substantive law as well as on the procedural level.

3 Sovereign Acts

A precondition for any claim to state liability is a sovereign act of the state. If the matter involves an act under private law then no special law comes into play. Instead the private liability laws are applicable.

The question concerning whether or not the state was acting under private law or in a sovereign manner is primarily decided by the legal form of the act: if the state is fulfilling its duties by setting standards, passing administrative laws, making

administrative regulations or by concluding contracts under administrative law, that allows one to conclude that the state was acting in a sovereign manner. If, however, the public body is acting through a form of private law, it is performing a non-sovereign act. Such non-sovereign acts include fiscal administration (participation of the public sector in general legal relations as a bearer of private rights; e.g. the purchase of office material to cover its own needs) as well as the participation of the state in general economic competition (e.g. as a business shareholder).

It is, however, difficult to categorize an actual act (a so-called “real act”), since it does not outwardly display the criteria of the legal form in an easily recognizable way. In that case the nature of the task and its functional context are to be analyzed in lights of the sovereign duty of the institution. It is of decisive importance whether the objective being pursued belongs to the range of duties within the sovereign sector and whether an inner and outer connection exists between that objective and the act itself.

If the act still cannot be clearly ascribed to the one of the two sectors of activity, then according to predominant current opinion a rule of assumption applies: if the state has acted in order to fulfill its duties under public law then the act is to be interpreted as an act of public law as long as there is no clearly apparent contrary intention of the public office to have acted according to the directives of private law.

4 Claims to State Liability

According to Section 839 BGB in conjunction with Article 34 of the Constitution (GG) a claim to state liability exists whenever a public servant has negligently breached an official obligation, that aims to protect a so called third party, in the performance of his official duties and the breach of the official obligation is the cause of the damage that occurred and liability cannot be ruled out or limited in that particular case.

The public servant must have been acting in the fulfillment of the duties of the public office he has been entrusted with. A claim to state liability can therefore be ruled out if the damage occurred “merely incidentally” during the performance of the public office. The objective of the action must be ascribable to the sovereign sector and there must be an inner connection between the damaging act and its objective. That connection is lacking if the act was completely unrelated to the performance of official duties and the only connection between the act and the public office was that the act was performed during office hours.

An essential further prerequisite for a claim to state liability is the breaching of an official obligation protecting a so called third party. Official obligations arise on the basis of laws, subsidiary legal standards, administrative regulations and special official orders. However, these official obligations can be considered as obligations protecting a third party only if and when they at least had the collateral purpose of providing protection to that party whose rights were infringed upon. The opposite of such obligations to third parties are official obligations that serve only to maintain

public order or serve the interests of the state through the proper performance of the official duties associated with the public office. The German Supreme Court in civil matters (BGH) decides if the official obligation breached was originally conceived for the purpose – not necessarily for the sole purpose but also for the purpose – of protecting the interest of the party who has suffered the damage. That party must belong to the specific circle of people whose interests were to be protected and promoted by the official obligation in terms of its objective and legal definition.

The breach of duty must also involve at least simple negligence. Negligence is to be assumed if the public servant did not take the necessary care in the performance of his official duties. According to the opinion of the BGH, an objective abstract measure of care is to be applied, which is based solely on the average amount of knowledge and insight that is necessary to perform the duties associated with a particular public office and does not take the actual personal capabilities of the civil servant in question into account. Every public servant must therefore have or acquire all of the legal and administrative knowledge necessary to perform the functions of his office. Insofar as a public servant is not able to perform his official obligations because the public office is understaffed or does not have sufficient material resources, he is exempt from being personally charged with negligence. There are nonetheless still grounds for liability action against the state: negligence can be construed on the basis of an organizational negligence: a public office has the obligation to provide sufficient resources to cover periods of illness and vacations and to make sure that no single person is overburdened with work. Thus, although personal negligence can be ruled out on the part of a public servant lacking sufficient resources, the public office is fully liable.

An objectively incorrect interpretation or application of the law is negligent if it goes against the clear and unambiguous wording of the regulation or if any doubtful issues arising from it have already been clarified by judicial decisions of the highest court. If, however, a panel composed of several professional judges (nonetheless) declares the official act to have been lawful, as a general rule, negligence is to be denied, as it cannot be expected of a public official to have any better knowledge of the law than a judicial court.

Liability action against the state furthermore requires that the breach of official obligation was an adequate cause of the damage. Here it must be investigated how things would have proceeded had the public official acted in accordance with his obligations and what the financial situation of the party suffering the damages would have been in that case. Adequate causality, however, exists only if the breach of official obligation was capable of causing the damage by its very nature and not because of some unusual, very improbable circumstances not worthy of consideration in the regular course of events.

Section 839 BGB provides for three limitations of liability: the subsidiary clause of Section 839 Section 2, sentence 2, the judicial privilege under Section 839 Section 2 BGB and exemption from liability due to negligent failure to take advantage of legal recourses as per Section 839 Section 3 BGB.

Because of the subsidiary clause, a case involving negligence on the part of a public servant in which all of the other prerequisites for liability action against the

state have been fulfilled, has a chance of success only if the party whose rights have been violated does not have any other recourse for demanding restitution. The party suffering the damage must therefore accept being referred to a third party for damage compensation if that third party shares responsibility with the public office for having caused the damage.

According to Section 839, Section 3 BGB there is also no obligation to provide compensation if the party whose rights have been violated negligently refrained from avoiding the damage by not making use of the legal recourses available to him. Anyone who incurs damage as a result of an unlawful sovereign act thus cannot simply sit still but must instead initiate the proper proceedings to ward off any damage before it occurs.

5 Procedural Assertion of State Liability Claims

The complexity of state liability law puts considerable barriers in the way of a successful assertion of a claim. An investigation commissioned by the Federal Ministry of Justice shows that of the 271 cases taken to court on a communal level, damage actions were dismissed in 219 of them with the argument that there had been no breach of official obligation or no negligence. This has to do in part with the numerous legal pitfalls that the party finds confronted with: in the preliminary phase of taking liability action against the state the person affected must, because of the subsidiary clause, make use of the all available legal recourses. Due to the referral clause of Section 839 Section 1, sentence 2 BGB he can also be forced to attempt to “recover damages from a third party” by bringing his case against a conceivably liable third party before being allowed to sue the state. The party whose rights have been violated could therefore, in certain cases, be compelled to file several consecutive or parallel suits.

If it is not certain and cannot be proven that all of the previous requirements for a claim to state liability have been fulfilled, the person suffering the damage must look for further grounds on which to base his claim. It might be possible to assert a claim on those grounds in a different court. In actual practice it is often overlooked that even claims to state liability with little monetary value are to be filed from the start with the Higher Court (*Landgericht*), which has exclusive jurisdiction for all liability actions against the state regardless of their monetary value. It is not permissible to take liability action against the state in a municipal court (*Amtsgericht*).

Case-law interpretations of specific details contained in the statutory definitions are shrouded in uncertainty. This applies particularly to the requirement of the breaching of an official obligation protecting a third-party, which the German Supreme Court (BGH) uses as a definitive corrective measure in liability cases and which not surprisingly is called the “crux of state liability” in legal commentaries. There are no truly reliable criteria for determining the third-party protection of an official obligation. The results are all the more fatal as the way in which the nature and the extent of the breached official obligation are interpreted generally determines the outcome of the proceedings.

The party pressing charges often overlooks the fact that under Section 839 Section 1, sentence 2 BGB he carries the burden of arguing and proving that there is no alternative way of recovering his losses. Liability actions brought against the state are often incomplete because the parties filing them omit the statement of such “negative fulfillment of the statutory definition.”

Problematic is furthermore the question of whether or not, and if so to what extent, the court is bound to the decisions of the public offices, especially to administrative acts that cannot be brought to court any more because of missing the period for filing an action and to the decisions of the administrative courts. Such binding influence can potentially determine the outcome of the case.

6 Case Categories

6.1 Unlawful Denial of a Business Permit

It is possible that an entrepreneur needs various permits before being able to get started in business, for example a license to trade or a building permit for the construction of an operational facility. Such permits must be issued if there are no legal obstacles in the way. It is therefore a breach of official obligation, for instance, if the public office in charge of issuing building permits denies an application or unlawfully makes it contingent on the fulfillment of certain criteria although there are no special reasons for doing so.

The amount of the damage caused by the unlawful denial of a permit is to be figured by a special method. The actual financial situation of the person incurring the damage is weighed against the scenario of what his financial situation would have been like if the incident had not occurred. The difference, or margin, can be recovered, which – in the case of the denial of a building permit, for example – would include any increase in construction costs as well as the loss of rent intake.

6.2 Delayed Issuance of a Permit

The civil servants working in the public office in charge of issuing permits have an obligation to provide the applicants with correct information based on the pertinent regulations concerning the applications or in regard to any preliminary questions they might have and to do so in a timely manner. The determination of what constitutes a timely manner must be made by taking the particular circumstances of the individual case into account. It cannot be assumed from the 3-month deadline that is foreseen for the filing of an action because of inaction of the official servant that a breach of obligation never occurs until after the period of 3 months has elapsed. The deadline for reaching a decision can be set much earlier if, for instance, the

public office was already familiar with the matter on the basis of applications that had been filed previously. Other factors play an important role in determining what constitutes a timely manner for response: the volume and the difficulty of the matter as well as the amount of time required to obtain the opinion of other public offices.

In the case of an unlawfully delayed permit the party concerned has a right to claim compensation for the damages he suffered during the delay, which begins with the day on which the permit would have been issued if the civil servant, in keeping with his obligations, had declared his agreement with the application and processed it properly. The unlawful delay ends on the day on which the permit is actually issued. The party suffering the damage is to be compensated in such a way that he is no worse off than he would have been had his application been processed in a timely and proper manner.

6.3 Liability of the State for False or Incomplete Information

Before filing an application for a permit, entrepreneurs often turn to the public office in charge with the request for information about the permissibility of a specific project. In answering such questions, the public office has the obligation to provide correct, clear, unambiguous and complete information. That holds true not only for written but also for any oral information.

The official obligation to provide correct and complete information exists towards the recipient of the information as well as towards all of the persons for whom the information is clearly intended. If, for instance, the public servant ought to be able to realize that a written confirmation attesting to the permissibility of the development of a plot of land is intended to be presented to a prospective buyer of the property, then he also has an obligation towards the prospective buyer. The German Supreme Court (BGH) has ruled, however, that there are no claims if the party did not rely in good faith on the information and therefore the information is not a “reliable basis” for his actions. Thus the criteria of trustful reliance is not met in cases in which, for example, the public office provides (false) information but at the same time explicitly refers to the necessity of an approval procedure before the questions can be definitively answered.

6.4 State Liability in the Commercial Law Sector

In dealing with applications for the issuance of a business license the public servant in charge has, above and beyond his regular official duties, a special official obligation to reach a quick decision on the matter if a change in the law is forthcoming that could hinder the approval of an application that has been filed. The application must be approved even if the project it proposes runs contrary to the intention of

the laws that are in the making but is still permissible under the laws currently in force. In a case that was decided by the German Supreme Court the party claiming damages had applied for a permit to operate an amusement arcade. Since the civil servant in charge of handling the matter was aware that law governing amusement arcades was about to be changed and the proposed project of the claimant could only be approved under the laws that were still applicable but about to be replaced, he drug out the process of making the decision long enough to make it impossible to approve of the project in its proposed form under the new regulations. This behavior obviously constituted a breach of official obligation and made the state liable for the payment of considerable damages.

Whenever the urgency of an application is apparent or ought to be apparent to a civil servant, he is responsible for making all other official parties involved in the case equally aware of the urgency of the matter. A period of eleven days is thus considered an unacceptable delay for obtaining legal information from the legal office of the public agency concerned with the matter. The civil servant also has the obligation of formulating his question precisely enough to avoid any delay in processing.

6.5 State Liability in the Crafts and Trades Sector

Numerous chambers of commerce offer an extensive amount of professional advice including advice on how to get started in business, on bookkeeping, on cost figuring, on investment, resource and financial planning and on assessment of the value of a business. Because of this very wide spectrum of topics these advisory services involve a high liability risk. A further challenge is presented to these organizations by the European service directive, which allows them to act as the sole contact person to a foreign entrepreneur. The sole contact person is supposed to function as a typical one-stop agency to foreign companies, offering them assistance with all of the procedures and formalities involved in setting up and getting started in a service-providing business and has the intention of considerably facilitating the commencement of business operations by foreign companies.

The official obligations that are to be observed here are subjected to the same general principles that apply to the liability of experts since the consulting services are, in effect, an expert opinion. Hence, the advice offered must be correct, clear, unambiguous and complete.

These official obligations protecting a third party exists on the first hand to the benefit of the members of chambers of commerce. The purpose inherent in the consulting services is to protect and promote the business-related interests of the members of the organization, who approach it in search of answers to their questions. It is, however, a matter of controversy whether or not third parties who are not members of the organization but who have nonetheless put their faith in the correctness of its advice fall within the range of coverage of the official obligation to provide protection. This is generally not the case. The party who has suffered the

damage is covered by the official obligation to provide protection only if and when he has entered a special relationship with the organization. Such can occur, for example, if he has asked the organization together with one of its members, placing a considerable amount of importance on the advice requested, and the organization has complied with his request.

Besides the business consulting services, a large portion of the consulting activity of trade organizations is comprised of the provision of legal and tax advice. When compared with the business consulting services, the rendering of legal advice plays a special role. That activity is normally performed by attorneys and certified public accountants – two highly specialized groups of professionals whose practice is regulated by professional codes of conduct. Naturally that is taken into consideration by the liability regulations, which provide for the same standards as those that are applicable to licensed attorneys and certified public accountants. A difference in the level of requirements would not only be irreconcilable with the laws against unfair competition, which demand equal treatment of various service providers, but it would also be irreconcilable with the necessity to protect the interests of the parties involved. The person seeking advice from his organization has exactly the same need for protection against misleading advice as does any other client.

In other words, the legal advice that chambers of commerce provide for must be comprehensive and exhaustive. Points that are critical to forming an opinion on legal issues must also be clarified in follow-up consultations if necessary. If the advisor makes any suggestions about how to proceed or if he shows that there are several alternative possibilities, he is obliged to select the surest and safest option.

6.6 Liability of the State for False Product Information and Product Warnings

Public information is an important influential instrument of state authority. Of particularly high ranking importance is the state's ability to provide information about certain products in the form of statements, recommendations and warnings. The purpose of such measures is not to establish any legal consequences but rather to influence and control behavior of the people.

If this information-providing activity is directed at specific products or product groups in the sectors of environmental or health protection or in the foodstuffs industry, it can give rise to conflicts with the manufacturer or distributor of the product if the statements made by the government have a negative impact on sales. The public interest in receiving comprehensive information from government sources about potential dangers thus often collides with the interests of the entrepreneur, who does not want to suffer any revenue loss due to the government's statements.

The government agency concerned thus often finds itself faced with a dilemma. On the one hand, public health and safety is at risk due to a dangerous product, whereas on the other hand an unjustified official warning could ruin the company

that marketed it. Such crisis situations are prone to error and can give way to liability action against the state in accordance with Section 839 BGB.

The extent and intensity of the danger will determine which of the possible information measures the public office will have to resort to in any particular case. The civil servant in charge will have to investigate whether or not a health risk is inherent in the product at issue or whether the product has merely an inconveniencing or nauseating effect. Any mistakes made in the diagnosis of the risk could amount to a breach of the official obligation to appropriately determine the actual nature of the danger. If the public servant does not have the necessary special knowledge of the subject matter, then he has the official obligation to procure it from someone who does. This obligation is of particular importance in the food-stuffs industry and the environmental sector since it is normally not possible to assess the danger without scientific understanding of the subject matter.

A public warning against a product, as an *ultima ratio* measure, can only be issued by state authorities when and if there are no other remedies available that would be equally effective, particularly warnings issued by the manufacturers themselves. The public offices in charge have the primary obligation of making sure that the manufacturers publicly issue the warnings necessary to ward off the danger. Such cooperation between the government and the manufacturer is required as a general rule because it is believed to constitute the most efficient way to counteract any danger given the fact that no one has any better knowledge of the product than the manufacturer himself.

The formulation of the warning must make sure that the warning is limited to the complaint-ridden product. It must not have any detrimental influence on the company or any third parties that go beyond that. The public official must therefore pay close attention to both the form and the content as well as to the temporal and geographical impacts of the warning.

The principle of proportionality gives rise to an official obligation to lift a warning without delay should the suspicion of danger turn out to be unwarranted. The warning is to be lifted in the same manner as the warning was given in the first place. The company concerned should, however, weigh out the consequences of further negative publicity and the damages it could cause. That is why it is proper and in keeping with official obligation for the administrative office to notify the public that the warning has been lifted only if the company concerned is in agreement with this manner of proceeding.

Because of their wide-ranging effect product warnings issued by public authorities tend to develop uncontrolled momentum through the interplay of state authority, multiplication and distortion by the media and misinterpretations of this information by consumers. In that manner they can have a powerful impact that was completely unintended. Wide-reaching impacts caused by public warnings can thus make it difficult if not impossible to prove any causal connection in state liability proceedings. One such case was brought before the Higher Court of Dusseldorf in which a public office had issued a warning in regard to the discovery of the presence of forbidden hormones in the meat being packed by a particular company. That warning, however, was issued at a time when the media were reporting about

a “hormone scandal” that had nothing to do with the case in question. The court dismissed the liability action being brought against the state by the company, which was seeking compensation for the damages it suffered due to a drop in sales and lost profits, on the grounds that there was no causal connection. The court asserted that consumer behavior in general had changed as a result of the hormone scandal. The causal influence of the hormone scandal thus could not be isolated from the effect of the warning issued by the authorities.

7 Liability Claims Against the European Union

Just as liability claims can be brought against the Federal Republic of Germany they can also be brought against the European Union if it is guilty of an unlawful act. Recently, for example, the European Commission was ordered by the court of first instance to pay an enormous sum by way of damage compensation for having unlawfully denied two companies the right to merge.

German state liability only comes into play when the unlawful deed can be ascribed to a person invested with the power of the German state. If an individual suffers damages as a result of an infringement of his rights by the public institutions or servants of the European Union, he can make no claims based on German law or on the basis of an expropriation-like intervention. The liability of the Community instead derives from Article 288 EC. That regulation regulates on the one hand liability stemming from a breach of a contract between the party concerned and the Community (“contractual liability”) and on the other hand liability for unlawful practices on the part of the institutions and servants of the Community in the performance of their duties (“non-contractual liability”).

Article 288 EC, however, only contains a part of the statutory requirements. The Community is liable for the compensation of any damage caused by its institutions or by its servants in the performance of their duties in accordance with the general principles common to the laws of the member states. This reference to the general principles common to the laws of the member states causes considerable interpretive problems. According to general opinion, it contains an entitlement of the European Court of Justice (ECJ) to develop the criteria for the liability of the European Union on the basis of the laws of the member states. In making its decisions, however, the ECJ rarely takes comparative law considerations, or considerations of the liability systems of the member states, into account. European case law in actions for damages against the state has thus developed so independently that numerous principles of national liability law are only given limited consideration if any at all.

The requirements that must be satisfied to establish the liability of the European Community are: a wrongful act or omission by an EC institution or by its servants acting in the performance of their duties, a wrongful breach of a protected right and a causal connection between the wrongful act and the damage caused. Fault or negligence on the part of the institution or servant does not seem to be a requirement. However, there is no ruling of the ECJ that offers a failsafe guideline.

As opposed to the situation under German law, the European Community is also liable for damages that occurred as the result of legislative unlawfulness. The reasons for this are primarily of a regulatory nature. The liability of the EC for legislative unlawfulness is supposed to compensate for a deficit that exists because the EC offers no sufficient legal protection of the individual against unlawful regulations comparable to that guaranteed under the law of the member states. The Community is not, however, liable for every breach of law that occurs in the course of legislative action. According to the rulings of the ECJ, liability exists for legislative action involving measures of economic policy only if there has been a “sufficiently flagrant violation of a superior rule of law for the protection of the individual.” The concept of “legislative action involving measures of economic policy” is to be understood in the broadest sense: it is not limited to economic measures in the strictest sense but rather encompasses all of the areas where EC institutions have a wide discretion to legislate on matters involving choices on economic policy. A sufficiently flagrant violation of EC law exists if an EC institution has “manifestly and gravely” disregarded the limits of its powers. The determining factors here are primarily the significance of the violated rule of law, the number of people affected by the unlawful regulation and the lack of adequate cause for the behavior of the EC institution. Due to the uncertainties that exist, it is very difficult to predict the chances of success of damage actions on the basis of wrongful legislation. It is thus not without good reason that it is recommendable to initiate such proceedings only if the wrongfulness is flagrant, the circle of persons affected by it can be clearly defined and the action is aimed less at actual damage compensation than at warning the EC to discontinue its unlawful practice.

Damage action brought against the EC under Article 288 EC falls within the jurisdiction of the court of the first instance of the European Community. Without exception all national courts lack jurisdiction; even a preliminary hearing in a national court aimed at examining the unlawfulness of an action taken by an institution of the EC is not admissible.

Part III
Labor Law

Aspects of German Labor Law

W.D. Schenk

1 General Aspects

Labor law regulates contracted relationships between employers and employees. The liberal concept of contractual freedom is based upon the economic equality of the contracting parties. During the industrial revolution it became clear that there was no such equality between workers and employers, so a movement evolved to construct the legal corpus of thought necessary for the protection of employees. These early developments became the springboard for current German labor law and their incipient ideas can still be found in the administration of justice. That is particularly apparent in the fact that labor law itself still determines when an employment relationship subject to labor exists, granting employees no freedom to waive that right, which was created for their own protection.

The influence labor law has had in shaping modern German society and its economic constitution cannot be underestimated. The state's interest in forming the underlying concepts and principles of employment relationships is demonstrated through its legislation. This was again recently the case with the new amendments to the laws governing unfair dismissals and temporary employment contracts.

Social welfare law is closely related to labor law despite the fact that in Germany the courts representing the two entities each have exclusive jurisdiction: there are labor courts (*Arbeitsgerichte*) and social welfare courts (*Sozialgerichte*). Specifically, social welfare law regulates different kinds of social security and insurance (retirement, health and disablement insurance, accident insurance), welfare, unemployment relief and work permits.

In the past employees (*Angestellte*) and workers (*Arbeiter*) were treated by law as distinct entities, but due to Federal Constitution Court decisions it is no longer acceptable to consider this distinction binding in all cases. Today it is only of importance in the organization of social insurances. For the remainder of this chapter the term "employee" shall denote both employees and workers.

2 Sources

Labor law is influenced by the Civil Code (contracts of service law), the Commercial Code (commercial employees) and numerous special acts such as the Vacation Act, the Continued Payment of Wages Act (during illness of employee), the Working Mothers Protection Act, and others. It should be noted that because regulations in the Civil and Commercial Codes are rather short, it is difficult to extract existing labor law from them. Hence labor law is case law to a wider extent than the other fields of German law.

The European Community also influences German labor law through their so-called guideline competence and through the decisions of the Court of Justice of the European Community; for instance, there are decisions and guidelines banning discrimination within employment relationships on the basis of gender.

Also, it should be noted that collective labor agreements belong to the sources of labor law.

3 Employment Relationships

The employment relationship is formed by a contract by which, roughly speaking, the employee is obliged to give his time and working skills, and the employer to furnish the possibilities for the employee to work and to pay the salary. In Germany, the employer has to finance half of the contributions to social insurances (illness, pensions), and he is obliged to retain the monthly employee's share of these contributions and pay it to Social Security together with his share. He has to pay the monthly tax of the employee as well. So, if one speaks of "salary" one has to decide whether the gross salary (including social security and tax) or the net salary is meant.

Typically, an employment relationship lasts for an indeterminable period and the law states that there must be well defined reasons to delimit their duration. But the new Part-time and Temporary Employment Act, which replaces the Employment Development Act, permits temporary contracts to a much wider extent without the provision of good reason. Temporary short-term contracts covering employment periods of up to 2 years are now permissible under the new law. That, however, does not apply to contracts with employees over the age of 52 (the age will be raised to 58 in 2006). It is also very important to note that this issue is highly controversial in regard to its conformance with European law and it furthermore raises social security problems that have yet to be resolved. In any case an existing permanent contract cannot be replaced by a temporary one.

Employers and employees are free to enter into part-time employment contracts. The new law furthermore grants full-time employees the right to exchange their full-time contracts for part-time ones under certain conditions. The most important stipulation is that working part-time only would not be contrary to the employee's actual financial needs.

Employees over the age of 56 can request to work “part time,” which means that they would continue working full-time but that their retirement would begin earlier. The state subsidizes such early retirement programs.

Temporary and part-time employees have the same legal rights and kinds of protection as any other employee.

Another class of relationship is the trial period employment relationship. These relationships are permitted but the trial period is not allowed to exceed 6 months. As these arrangements sanction shorter periods of dismissal notice, an employee who has not completed the 6-month trial period cannot benefit from protections against dismissal.

Apprentices are considered employees and there are special regulations governing these relationships. Apprentices must have the opportunity to attend vocational school.

A category of “employee” that is growing at a significant rate is constituted of those who work at home. This type of employment is increasing primarily because modern computer technology has made it possible to perform work in geographic locations different from those of traditional firms (so called “tele work/Telearbeit”). According to the above criteria, home workers and “tele” workers are not employees, but through a special act they have attained the same status as employees. Accordingly, one can infer that “tele” work can be regarded as a true employment relationship if the employee has the responsibility of being available online at a pre-specified time.

4 Who is an Employee?

Not everybody who renders services to another party is an employee, such as doctors and patients, lawyers and clients, craftsmen and customers, and so on. Such contracts are not within the aegis of labor law. Whether or not contractual relationships are subsumed under labor law is dependent upon whether the one obliged to render services is integrated into the organization of an employer; whether or not he is bound by instructions, if he has to work within certain hours; whether or not he has to work at a fixed location within the company, and so on. Problems may arise especially if a so called “free-lance” relationship is agreed upon.

The employer who offers work on a free-lance basis often has an interest in his employee not being legally defined as an employee. In this way certain tax and social security expense advantages can be accrued, and, above all, these approaches to labor contracts are often considered a means of avoiding labor law stipulations that would be applicable otherwise.

In many cases the labor courts have hindered such free-lance employer/employee schemes. Many contracts that originally qualified as free-lance based have been transformed into employment contracts via arguments of employer integration; even contracts like partnership agreements, contracts for work and services, and franchise contracts have been forcibly transformed (catch word: sham free-lance based/ “Scheinselbststaendigkeit”). The state demonstrates its interest in such relationships in response to tax and insurance policy; that is, the state seeks to ensure that salary

taxes and social insurance contributions in every work relationship are properly addressed. In fact, the employer has been made liable for such payments; therefore an employer is at great risk should he compensate a worker on a free-lance basis when in reality a true employer/employee relationship exists. Payment “spot-checks” are often used by the state as an instrument in enforcing these matters.

By law a representative of a legal entity is not subject to labor law (this is the case for a managing director of a limited liability company, a member of the board of directors of a stock corporation, an officer of a registered association or of a registered foundation). The reasoning for this is clear: because these individuals execute the will of the legal entity they represent, they cannot be subject to its will.

So-called executive officers (“leitende Angestellte”) work in the decision-making centers of institutions. They are subject to special treatment by law. However, there is no clear definition for an executive officer; it depends on the case at hand. One indication that may help in discerning this takes place at the point in time when the employer decides which of his staff members will work with him. Executive officers are employees; functionally, however, they belong on the employer’s side which is why the law grants them a special position. As such, they are not entitled to vote for the shops council; instead they have their own speaker committee. Additionally, they are not subject to regulations concerning working time, so they do not receive payment for overtime. Another feature, though less desirable, includes the fact that their employment contracts can be terminated more easily; but as a higher threshold of good faith towards their employer is generally a precondition for employment, there are no stringent requirements for dismissals due to questionable behavior. The employer can also terminate the relationship without citing reasons as long as appropriate compensation is offered. Labor courts have the power to impose such compensation (see Sect. 9 “Termination of Employment” below).

5 Employment Contracts

It is possible for parties to enter into employment contracts orally or even by implication, which of course can create difficult circumstances regarding proof of contract; therefore it is always advisable to enter into written contracts. Apart from this, at least 1 month after the confirmation of the relationship, the employer is obliged to write down the essential terms of the contract, endorse the document and then transfer it to the employee.

Should the employer fail to fulfill this obligation, the employment relationship will still be in effect. The employee thus retains the right to receive a written and signed document which has to include all the terms as required by law.

In principle the partners of a contract are free to agree upon the terms they wish; but in fact this freedom is restricted. Already the law includes certain restrictions on periods of notice, working time and so on; furthermore, the parties are bound to the regulations of existing union agreements; and finally, there are the arrangements between the employer and the shop council that must be respected.

The most important responsibility of the employee is his commitment to work. The employee must be at the employer's disposal during the designated working time and the employee must refrain from any activity that could prejudice his work. This could range from excessive drinking to the participation in such activities as sporting events that could result in injury. Violating any of these provisions can provide grounds for dismissal.

An employee has the right to practice other occupations while working for any given employer as long as his work performance for that employer is not compromised.

The employee has certain duties of good faith to his employer. During the existence of the employment relationship the employee is not allowed to work for a competitor and consequently to transfer company secrets. This regulation, however, is not applicable once the relationship is terminated. Should the employer wish to obstruct his former employee from working for a competitor, the employer and the employee must enter into a written contract which is enforceable for at most 2 years and which guarantees that the employee receive at least 50% of the salary he received at termination.

An employment contract is not void because one of its provisions is in violation of law. In fact, only the specific provision in question is invalid until it is replaced.

6 Anti-Discrimination

In June/July 2006 the Parliament passed the Anti-Discrimination Act (Allgemeines Gleichbehandlungsgesetz), thus following the guidelines of the European Community, though the fundamental concept of non-discrimination has been part of German Law since the 1949 Constitution of the Federal Republic and the Civil Code had a provision against sex discrimination which has been replaced by the new act.

But what was since has widely been let to the Courts and has been executed with admirable results, is now formulated by Law. Its provisions are more specific – which means the Labor Courts will take the opportunity to extend their jurisdiction in favour of the employees.

The employer is hindered to base any inequality on considerations of race, sex including sexual identity, religion, disability and age. For example, if an employer places an ad that he looks “for a young male islamic IT specialist”, the new act gives an old, female christian IT specialist the right to sue the employer for damages because she did not have the chance to get the job. So the employer has to be very cautious in formulating his reasons of defining any employment conditions, may it be in the state looking for employees or in the course of the employment.

To avoid the consequences of the Law the employer should not give any reasons for his decisions, even if he wants to employ the young male Islamic specialist. Evidently, it is very difficult to prove a discriminating background which only exists in the employers mind.

Of course, the Law does not require the employer to offer a job for promoting female fashion to a man or work on a construction site to a disabled person. If the distinction is reasonable, the Law does not apply.

7 Collective Bargaining Agreements

In addition to being subject to the terms of individual employment contracts, the conditions of employment can also be subject to collective bargaining agreements. Collective bargaining agreements are arrangements between labor unions and either employer's associations or single employers, and they can be found in many trades, especially in the most important ones.

Collective bargaining agreements contain regulations that may cover a wide range of issues such as the fixing of minimum salary levels, the fixing of periods of notice that may exceed legal limits, industrial safety regulations, etc. The provisions of an individual employment contract are substituted by the collective agreement if its minimum requirements are not met. For instance, it is only possible to agree individually to a higher salary or a longer period of notice than those provided for by the collective agreement.

Collective bargaining agreements are only binding the parties and their members entering into the agreements. It should be noted that an employer can apply the same provisions to employees not bound by these agreements, although there exists no obligation to do so, and as long the conditions of the collective bargaining agreement are not to the detriment of the employer's contractual rights. Furthermore, it is often agreed that a collective agreement forms part of the individual labor contract if one or even both of its parties is not bound by the collective agreement as such. The reason is that collective agreements normally balance the interest of employers and employees appropriately.

The government can declare collective bargaining agreements generally binding, which has the effect of extending their coverage to all relevant employment relationships and, thus, have in effect the power of the law itself. In most of the leading trades, but not only there, such generally binding collective agreements exist.

Collective bargaining agreements can be restricted both geographically and in terms of their duration. They can also be terminated. The right to terminate is often used when labor unions wish to secure better terms, however it should be kept in mind that a collective bargaining agreement remains in effect despite termination until a new agreement is concluded.

8 Conflict of Laws

In principle the partners of the employment contract are free to apply a law different than German law for the employment relationship. It is possible, for instance, to implement American labor law in the case of an American sent to Germany. However,

an important limitation exists: the relationship is not allowed to deprive the employee of specific protections regarded by German law as binding in all cases. This can only be determined by comparing and contrasting the corresponding regulations of German law with those of the alternate law. Protections against dismissal, the regulations addressing the continuation of the employment relationship in cases where businesses are sold, the regulations concerning juvenile work protection, the regulations addressing protective legislation for working mothers and the regulations pertaining to the protection of severely disabled persons are regarded as binding by the administration of justice. Also, compliance with union agreements is required by law.

9 Termination of Employment

Dismissal notices and resignations are only valid in written form; the same applies to termination by mutual consent.

In principle, every employment relationship can be terminated. The employee is free to do so and has only to keep the notice period, whereas the employer is more confined and must adhere to certain rules. Certain collective bargaining agreements mandate that after a specified duration of time, the employee is “non-dismissable”. This, however, does not exclude the so-called “exceptional dismissal” (see below). Public services, in particular, conform to this format, but it is also found in other areas of employment and occasionally in individual employment contracts. German labor law does not go as far; the duration of an employment relationship is only of importance with respect to periods of notice. Periods of notice expand depending upon the duration of the relationship: if the employment relationship has lasted between 2 and 20 years, the period of notice extends to 1 month beginning with the end of the calendar month; and after 20 years, 7 months beginning with the end of the calendar month.

The employer is not entirely free to dissolve the employment contract. The Termination of Employment Act defines certain parameters restricting his rights to do so. Its provisions, however, are applicable only to companies with more than ten permanent employees (or five permanent employees if all of them were hired before December 31, 2003). Employees who are laid off before having completed 6 months of service are excluded from protection against termination.

Under the Termination Protection Act, dismissals are considered under various circumstances. They depend upon the behavior of employee, upon reasons existing in the person of the employee, and upon urgent business needs.

The Act stipulates that every dismissal which is not socially justified is invalid. Dismissals are socially justified by reasons existing in the person of the employee (for instance, long absences due to different illnesses) or by reasons existing in the behavior of the employee (lack of collegialism, cantankerous behavior, etc.), but also by urgent business requirements.

The latter are problematic. Indeed, dismissals due to technical business requirements, economic reasons, or other legitimate business needs are in principle justified, but other circumstances must be considered. The following paragraphs address some of these particulars.

In principle the employer is free to organize his business in any way he deems necessary. If jobs are abolished, the court has no recourse for review except in cases where some form of abuse is evident; but before an employer dissolves a contract, it is his responsibility to determine if the affected employee can be transferred to another department within the business. When this occurs, the employer is in reality offering another contract while terminating the current one. The employee can challenge the initial termination at court with the reservation that should he lose, he can accept the offer for the new contract. In instances where sections of businesses are relocated, the employer has to make an offer of work to the affected employee at the new location. Should he fail to do so, then any employer-initiated termination occurring as a result of the relocation is invalid.

Again, for dismissals dependent upon urgent business requirements, the principle of “social selection” must be considered. The employer is not allowed to terminate the contracts of employees he doesn’t want; instead, he is required to consider which employees are most adversely affected by the dismissals. Relevant criteria for this is the length of service with the firm, age, family obligations, and possibly the consideration of other circumstances. As a rule, younger employees are least affected, and are therefore most likely to be released.

A precondition for “social selection” is that the circumstances of the work possessed by the affected employees must be comparable, that is, in reference to the rank of the affected employees and the type of work performed according to the individual labor contract. This constitutes a difficulty for the employee who desires to challenge a dismissal; for instance, some years ago, the Labor Court in Munich ruled on the occasion of a dismissal wave at Siemens AG that different groups of engineers were not comparable with one other because their contractual duties were different, though they had basically the same skills and education.

In every case the so-called “exceptional dismissal” even without notice is possible if the continuation of the employment relationship is deemed unreasonable. As a rule, valid reasons for the discontinuation of a relationship are limited to severe violations of the contract by the employee. If the violations are severe, as in cases of embezzlement or theft where even small amounts of money are considered severe, such exceptional circumstances render dismissal without the period of notice justified *ipso jure*. If the violations are not severe, then a repeat incident may lead to an exceptional dismissal, however, this is contingent upon the employee having received prior warning. In all of these cases the employer has to give notice within 2 weeks after the incriminating behavior of the employee came to his attention.

Of course these rules also apply to the previously mentioned “non-dismissable” employee. And furthermore, the non-dismissable employee can be dismissed if the employer decides that their work facility is to be removed in which case the affected employees have recourse to their common rights as outlined in the Termination Protection Act.

If an employee wishes to challenge a dismissal, he must file his appeal at the appropriate Labor Court within 3 weeks after dismissal. Should he fail to observe this, the dismissal will become effective. The employee can file an application for belated admission if he can prove that extenuating circumstances prevented him

from taking action in a more timely manner (for instance, receipt of the dismissal during a planned vacation).

The Labor Court has the power to decide if a dismissal is lawful or not. However, with two exceptions, it has no right to order a compensation. The first exception occurs whenever one of the parties files an application for termination of an employment relationship in one of the very rare instances in which continuation of employment would constitute an unreasonable demand upon both of the parties. The second exception involves the termination of contracts with executive personnel, as mentioned earlier. As a general rule, court-ordered compensation awards an employee one half of his estimated gross monthly salary for each year of employment. As long as compensation does not exceed the amount of € 7,200.00, it is tax-free and exempt from other federal deductions.

Higher ceilings exist for older employees.

In practice, about 80% of all the dismissal trials end with the parties agreeing to the termination of the contract and to the payment of compensation, and as a rule one begins with the above formula when deriving the compensation. Occasionally, however, there are cases where more extravagant or much lesser amounts of money are assessed, but this depends on the particular circumstances of the case and on the negotiating skills of the lawyers.

Compensations for job loss can also be agreed upon out of court and can even form a part of the employment contract. A special form of out-of-court agreement has been introduced by the new Termination Protection Act: when giving notice of termination, an employer can offer an employee 50% of his gross monthly salary for every year of employment by way of compensation under the stipulation that the employee refrain from contesting the dismissal in court. That does not mark any major change in the normal situation, as the parties have always been free to enter into such agreements. What it does do, however, is institute a special legal form as a possible means of terminating employment contracts by way of out-of-court settlement.

Certain groups of employees are protected from “routine” dismissals. Among them are employee representatives (e.g. members of the works council), pregnant women, mothers until the expiration of the fourth month after delivery, and severely disabled persons with the approval of competent authority.

10 Mass Dismissals

Special rules apply to mass dismissals. Definitions for this category include: when within 1 month, in a smaller firm (20–60 employees), more than five employees are terminated; in medium sized firms (60–500 employees) 10% or more than 25 employees are terminated; and in firms with more than 500 employees at least 30 employees are terminated.

The works council has to be informed and the employment office must receive notification of such mass dismissals. If the employer fails to provide such notification,

the dismissals are void. The employment office has certain interference options, e.g. forced compensation of the dismissed employees and short-time work.

The works council in particular can play an important role in mass dismissals. It can call for the bargaining of plans for the reconciliation of interests and social compensation. If management and the works council come to a deadlock, an arbitration board is formed, on which the chairman, normally a judge of the local labor court, has the decisive vote. (For more on this point, see “Employee participation in management” below.)

11 Transfer of a Business

Only in case of the acquisition of a business the rules of Transfer of Business apply, not in cases of merger or inheritance.

A special protection against unlawful dismissal exists in cases where a whole firm or sections of it are transferred to a new owner. According to Section 613a of the German Civil Code, dismissals that are a result of the transfer as such are invalid. This means that all employment relationships are transferred by law to the new owner. It does not include dismissals for other reasons. One such reason, as often encountered in practice, might be the reduction of available work due to reorganization. Even in connection with the planned transfer, any dismissal restrictions resulting from the provisions of Section 613a become inapplicable.

The employee is not obliged to accept the transfer of his employment. He has the right to disagree, which he must exercise in writing within 1 month after he has received the written notice of the transfer which must include

- The date or planned date of the transfer
- The reasons of the transfer
- Its consequences regarding his contract, his social security and economic aspects, for instance whether his old employer is or will be bankrupt
- The measures planned in respect of his employment

If the information is not given completely or incorrectly, the Federal Labor Court being very strict insofar, the deadline for the disagreement has not to be kept. The employee might challenge the transfer even after years.

Often it is not wise to challenge the transfer because the old employer has no more business and can terminate the employment on these grounds (but not on the transfer as such). But if it appears that the new employer is not efficient, the employee might be interested to remain with his old employer.

It is often disputed whether or not a transfer of business exists; for example, the European Court ruled in a 1995 case that a sole janitor employed by a firm in Hamburg, Germany constituted a part of the business establishment. Based upon the decision of the employer to contract an independent cleaning firm, the court ruled that the janitor automatically became an employee of the new cleaning firm. Although this judgment has been challenged by most of the German Labor Courts, it demonstrates the types of difficulties encountered in this area of law.

Collective bargaining agreements are not immediately influenced by transfers. Generally they cannot be changed for at least 1 year following a transfer, that is, unless the new employer is prebound to a different agreement.

12 Employee Participation in Management

German law acknowledges two forms of employee participation in management: (1) the works council's co-determination and (2) "co-determination" in the narrower sense of the Co-determination Act, where it is defined as the participation of employees in the supervisory boards of large firms.

12.1 Works Councils

The legal foundation for the formation and the activity of the works councils is the Works Constitution Act.

There is no obligation to form a works council; however, should employees choose to establish one, the employer is required to support that decision. This applies only to firms with more than five employees.

Organizations receiving exemption to this requirement include religious communities including their charitable and educational institutions.

Special provisions apply to specific institutions such as those serving ideological purposes such as political parties, the administrations of labor unions and employer's associations, health care and health assistance enterprises, the Red Cross, boarding schools, scientific libraries, etc. Very important are the special provisions for businesses that depend upon the rights of free speech, the freedom of the press and the freedom of reporting; thus, press firms, publishing houses, private television and radio enterprises are included in this category. Other restrictions in the powers of the works council can apply to businesses and institutions only so far as certain characteristics of these enterprises conflict with the provisions of the Works Constitution Act.

Works councils are associated with single business entities (the business unit). If an enterprise has several businesses, a central works council is formed, and in the case of a group of companies (organized combinations of several independent companies) a central works council of affiliated companies is established. The members of the latter two forums consist of members of the respective single works councils. They concern themselves with matters that are so encroaching that they cannot be resolved at the level of the single works council.

The individual members of the works councils are elected every 4 years by company staff. The expenses for the elections and the work of the councils are compensated for by the employer.

The law contains a catalogue of issues for which, and only for which, it entitles the works council to co-determination rights. They cover matters involving social,

personnel and economic issues, workplace specifications and environmental protection within the company. Generally speaking, it is only in an advisory function that the works council represents employee interests in dealings with management. It also has certain information rights such as the right to inspect payrolls, even the salary lists of non-tariff employees. However, anytime the inspection of the personal data of an employee is involved, his permission is required.

Co-determination in social affairs includes a great variety of things, such as issues of internal policy and codes of employee conduct, work hours, vacation scheduling (but not vacation length!), overtime and short-time work, etc. Most important is co-determination in matters concerning company wage policy, especially the determination of remuneration principles and the introduction, alteration and application of new remuneration methods. If, for example, the employer intends to introduce new, unified targets for field salespeople, he can do so with the consent of the works council, or, in other words, through "company agreement" which is binding but cannot waive the existing contractual rights of an employee. In other words, it is only binding for the future, and, as under collective bargaining agreements, employer and employee can agree to better conditions than provided in the company agreement. On the other hand an employee can waive a right granted him by a work agreement only with the consent of the works council.

Agreements can be terminated within a period of 3 months as long as no replacement agreements have been concluded.

If a company has more than 100 permanent employees the works council has the right to general information concerning the financial situation of the company. In the important event of planned changes in operation that would have a considerable negative impact upon the employees, the works council can intercede if the company has as few as 20 employees, its rights in that case far surpassing the mere right to be informed. Changes in operation in this sense in particular include reductions of the workforce (especially important here are mass layoffs), closing down operations entirely, relocation of operations or operational units, mergers with other operations, spin-offs, organizational reengineering, redefinition of corporate mission statements, changes in production machinery, introduction of completely new work methods and production processes.

In such cases the works council can encourage a reconciliation of interests; it does not, however, have a right to demand such. Yet it can enforce the creation of a social compensation plan to mitigate any resulting hardships for the impacted workers.

It should be noted that company agreements do not interfere with the contractual rights of individual employees. If, for example, new objectives or severance packages are determined through company agreement, the individual employee does not have to accept them. He can insist upon the objectives guaranteed by his own contract and, upon dismissal, sue his employer under dismissal protection laws without paying any attention to the social plan. Nevertheless the psychological effects of company agreements should not be underestimated, effects that can even influence court decisions concerning the fairness of the objectives and the legitimacy of the dismissals.

As regards individual personnel measures, the works council has the right to be informed in companies with more than twenty employees. It also has to approve new hires, interdepartmental transfers, departmental reorganizations and employee relocations. It can refuse to grant approval in certain cases, for example, if the hiring of a new person would necessarily result in the termination of another.

In terms of statistics at least, the most important right of the works council is its right to co-determination in dismissal processes, whereby no restrictions exist in regard to the size of the company. The council has the power to protest dismissals, which does not reverse them, but which is very dangerous to the employer: Should a lawsuit result over a dismissal, the affected employee retains the right to continue work and receive compensation beyond the established period of notice. Even if he wins the case finally – which can last several year given the possibility of appeal and second appeal – the employer has no right to get back the salaries he has paid after the end of the notion period because he benefited or could have benefited by the services of the employee. In such a case, for instance, the employer agreed to pay some 20.00,00\$ as compensation to a secretary who had only been employed 7 months rather to take the risk of paying her for probably 2 years.

The rights and obligations of the works council are supposed to be exercised in cooperation with company management but conflicts are inherent in the very nature of the arrangement.

Works councils can block the decisions of employers and if their rights have not been observed, employer decisions are void. This tends to foster an environment conducive to agreement between employer and works council, which can influence and even change employee working conditions, though not their contractual rights against their will, and which, of course, is limited to the issues on which the work council has co-determination powers. If management and works council become deadlocked on any issue, either one of them has the right to request formation of what is called a “conciliation committee.” This committee consists of equal numbers representing the employer’s side and the works council. Also present is an independent chairman, whose selection both parties must agree to. Customarily, the vote of this chairman decides the issues at hand because the vote is decided by simple majority and he has the one uneven vote that can throw the outcome one way or the other. As a rule, however, he initially attempts to design conciliatory solutions all parties can agree to. This latter approach has the advantage that such agreements cannot be challenged in the courts, whereas the arbitration awards of the conciliation committee can, to a certain extent, come under judicial review.

12.2 Co-Determination Law

The co-operation of employees within the parameters of Co-determination Law is very different. This law only applies to corporations with more than 2,000 employees. Religious communities, enterprises serving ideological purposes, and media concerns are exempt.

Co-determination requires that the supervisory board be staffed on a basis of equality with representatives of the shareholders and the employees. The representatives of the shareholders are nominated by the shareholders whereas the representatives of the employees are elected either in a direct election or by delegates. Often, officials of the works councils are on the supervisory board.

The supervisory board has considerable authority, especially during a business crisis. It can exercise powers to nominate or dismiss boards of management. In this respect, employees directly influence the operations of the corporation.

Naturally, the varying interests of the shareholders and the employees can lead to voter deadlock over controversial matters. In such cases, new votes are conducted whereby the respective chairmen of the supervisory boards claim two votes and thereby determine the respective outcomes.

Residence and Work Permit

M. Wendler

1 Law Applicable to Foreigners Seeking (Temporary or Permanent) Residence in the Federal Republic of Germany

1.1 *Right of Residence Issues*

As a basic principle every foreigner who wants to stay in Germany needs a valid residence title. The purpose of residence determines which conditions must be fulfilled in the individual case. The most important German act referring to issues of residence is the Residence Act (“Aufenthaltsgesetz”–AufenthG), operative from January 1, 2005, and last adapted to the European Union’s Directives on the law of residence and asylum by an implementing act operative from August 28, 2007. It regulates foreigners’ entry, residence, settlement, economic activity, and the termination of residence.

According to the Residence Act there are four different residence titles (Section 4 (1) AufenthG): visa, residence permit (“Aufenthaltsurlaubnis”), settlement permit (“Niederlassungserlaubnis”), and EC long-term residence permit. The residence permit is in principle a temporary permit whereas settlement permit and EC long-term residence permit are unrestricted, unlimited with regard to time and place, and they allow the pursuance of a gainful occupation.

1.2 *Residence Requires Permit*

In principle foreigners require a residence title for entry into and residence in the German federal territory in the absence of regulations to the contrary provided by either European Union law or statutory regulations (Section 4 (1) AufenthG). Entry and residence furthermore require the possession of a recognized and valid passport (Section 3 (1) AufenthG).

1.3 Treatment of European Union Citizens

According to the Freedom of Movement Act/EU (“Freizügigkeitsgesetz/EU” – FreizügG/EU), citizens of the European Union neither require a visa for entry nor a residence title for residence (Section 2 (4) FreizügG/EU). They are allowed to pursue self-employment as well as gainful employment in the federal territory under the same conditions as German nationals. Entitled to freedom of movement are Union citizens who either reside in Germany for occupational purposes or have both sufficient health insurance coverage and adequate means of subsistence (Sections 2, 4 FreizügG/EU).

Union citizens with the right to freedom of movement officially receive a certificate confirming their right of residence. Just as German nationals they must register with the competent registration office in compliance with the statutory registration provisions of the federal state they take up residence in. The registration office delivers these personal details to the immigration office which then officially issues the certificate.

1.4 Forms of Official Residence Titles

The different forms of residence titles designate the foreigner’s specific degree of officially acknowledged integration. Depending on the purpose of residence, there are numerous grades and differences in the legal status of the persons concerned. Residence title and work permit are issued in a single administrative act; the previous double permit procedure has been replaced by an internal approval procedure (so-called “one stop government”) involving the local immigration offices and the Federal Employment Office (“Bundesagentur für Arbeit”). The immigration office issues the work permit together with the residence title provided that the employment administration has given its approval (for details see Sect. 1.4.4 below).

The issuance of a residence title requires that the foreigner’s identity and, if the foreigner is not entitled to return to another country, his or her citizenship are determined, that the foreigner holds a valid passport, that his or her livelihood is secured, that there are no grounds for expulsion, and that the foreigner’s residence does not jeopardize or compromise the interests of the Federal Republic of Germany for any other reason provided there is no entitlement to a residence title being granted (Section 5 (1) AufenthG). In addition, the foreigner must have entered the country with the necessary visa and furnished the relevant information with his or her visa application (Section 5 (2) AufenthG) in order to be granted either residence permit, settlement permit, or EC long-term residence permit.

These requirements may be waived if the prerequisites for granting the residence title are met or if special circumstances render a subsequent visa application procedure unreasonable in the individual case.

1.4.1 Visa

The foreigner is required to obtain a visa prior to entry in numerous cases. A visa is a residence title for short-term visits issued by the German diplomatic representation. To be distinguished are the so-called Schengen visa for stays of up to 3 months (Section 6 (1) no. 2 AufenthG) and the national visa for stays of longer duration (Section 6 (4) AufenthG), which must be obtained prior to the stay (for exceptions see Time of Application in Sect. 1.5.4 below).

1.4.2 Residence Permit

The residence permit is a temporary residence title (Section 7 (1) AufenthG). It is issued for a limited period of time with regard to the intended purpose of residence (Section 7 (2) AufenthG) and is generally extendable (Section 8 (1) AufenthG). A right to the pursuance of an economic activity is granted only if so stated expressly in the residence permit.

The residence permit must be applied for at the locally competent immigration office.

1.4.3 Settlement Permit

The settlement permit replaces the previous unrestricted residence permits. It is a permanent residence title which allows the pursuance of an economic activity, and it may contain subsidiary provisions only in certain cases made expressly admissible by the Residence Act (Section 9 (1) AufenthG). It must therefore be basically unlimited with regard to time and place.

Everyone who has held a residence permit for 5 years, who is able to secure his or her livelihood and has been in employment for 5 years subject to contributions to the statutory pension scheme is entitled to be granted a settlement permit. A citizen of the European Union who has legally resided in the federal territory for 5 years is granted a settlement permit independent of further prerequisites. About this matter the Union citizen is given a certificate.

1.4.4 EC Long-Term Residence Permit

The EC long-term residence permit according to Section 9a AufenthG is another form of an unlimited residence title which is the equivalent in law to the settlement permit notwithstanding Residence Act provisions to the contrary. Implementing Council Directive 2003/109/EC, this residence title was newly introduced to the Residence Act with the German implementing act's coming into force as of August 28, 2007. For its issuance essentially the same requirements apply as for the settlement permit. In addition, special provisions with regard to the "quality" of the

previous 5-year residence must be observed (see Section 9a (1) to (3) AufenthG). The EC long-term residence permit may not be granted, in particular, if the foreigner has only resided for transitional purposes in the German federal territory within said period.

1.5 Purpose of Residence

The purpose of the foreigner's stay in the federal territory determines which permit is necessary. The new Residence Act also makes a distinction between the granting of a residence title for the pursuance of gainful employment or for self-employment.

1.5.1 Limited Residence for Educational Purposes

A foreigner may in principle be granted a residence permit for the purpose of a university application and for studies at a German university or a comparable institution of higher education including preparatory measures to be taken. This residence permit for educational purposes is granted for the duration of between 1 and 2 years. It may be extended if the studies have not been completed within this period (Section 16 (1) AufenthG). The duration of the stay of a foreign university applicant may not exceed 9 months (Section 16 (1a) AufenthG).

1.5.2 Residence for the Purpose of Gainful Employment

Until December 31, 2004 residence permits allowing an economic activity contained the clause that gainful employment was permitted "only in accordance with a valid work permit". The necessary work permit had subsequently to be applied for at the Federal Employment Office.

Since January 1, 2005 a new procedure has been in force. The work permit does not exist anymore. What kind of economic activity may be taken up results only from the subsidiary provision to each residence title. It is now the immigration office's competence alone to decide on the permission of employment.

In principle a residence title permits the pursuance of an economic activity either if determined by the Residence Act or expressly permitted by the specific residence title (Section 4 (2) sentence 1 AufenthG). A foreigner who does not hold a residence permit for occupational purposes may be permitted to pursue gainful employment only with the Federal Employment Office's approval (Section 4 (2) sentence 3 AufenthG). Apart from the decision on the residential regulation of a residence title with regard to foreigners law, the employment administration's decision on its approval for the pursuance of gainful employment is necessary (Section 39 AufenthG). A foreigner may also be granted a residence title for carrying out an occupation without the Federal Employment Office's approval if so determined by statutory regulation or intergovernmental agreement (Section 18 (2) AufenthG).

The granting of a residence title for occupational purposes in principle requires qualified vocational training (Section 18 (3) *AufenthG*). As a special exception a residence title may be granted if stipulated by an intergovernmental agreement. Access to the German job market is provided only if no German or privileged foreigner employees are available for the individual job opening throughout Germany (Section 39 (2) *AufenthG*). As a basic principle a residence title is granted only if the applicant presents a specific job offer (Section 18 (5) *AufenthG*). Improper access to the German job market is thus meant to be prevented.

Exceptions from the principle of mandatory approval are provided by the statutory ordinance on the admission of newly entered foreigners to the pursuance of an occupation, the Employment Regulation Order (“*Beschäftigungsverordnung*” – *BeschV*), issued in accordance with Section 42 *AufenthG*.

Gainful Employment Without the Federal Employment Office’s Approval

The *BeschV* provides for important exceptions from the requirement of the Federal Employment Office’s approval for the granting of a residence title. The essential exceptions are quoted in the following.

Highly Qualified Foreigners, Section 3 BeschV

The settlement permit to be granted to a highly qualified foreigner according to Section 19 (2) *AufenthG* does not require federal approval. Among the privileged highly qualified occupational groups are scientists with specialist qualifications, teachers and scientific assistants in prominent positions, as well as specialists and executive employees with special professional experience and a certain minimum salary.

Executives, Section 4 BeschV

According to the *BeschV* (Section 4 *BeschV*), the employment administration’s approval is not required for the granting of a residence title to executives. Executives in the legal sense are in particular:

- Executives with full power of attorney or procuracy,
- Members of the boards of a juristic person authorized to legally represent this juristic person,
- Partners of a general partnership (“*OHG*”) or members of a different kind of partnership if entitled by law, statutes or partnership agreement to either manage the business or represent the partnership, or
- Executive employees of an internationally active company who are of decisive importance to the company’s development, designated for an occupation on board or management level or another occupation in an executive function.

These exceptions make it easier for international companies to use qualified employees of deciding importance to the company’s development within the framework of employee exchange, pursuing the internationalization of company leadership.

Commercial Occupations, Section 6 BeschV

Persons employed for commercial activities abroad by an employer with a domestic head office (Section 6 no. 1 BeschV) and persons assigned by an employer based abroad to enter into negotiations and attend meetings in the federal territory, conclude contracts or purchase merchandise meant for export (Section 6 no. 2 BeschV) do not require the employment administration's approval for the granting of a residence title. The prerequisite is that those persons will not reside in the federal territory for a longer duration than 3 months observing a period of 12 months within the context of employment while maintaining their principal residence abroad.

Thus the opportunity is meant to be given to foreigners to carry out short-term transactions in the Federal Republic of Germany without major administrative effort. Foreigners can now establish companies or subsidiaries in the German territory in an uncomplicated way.

Assembly Work, Section 11 BeschV

Furthermore no approval is necessary for the granting of residence titles to persons posted to the German territory by their employer based abroad for up to 3 months within a period of 12 months in order, among other purposes,

- To erect and assemble machines, plants and programs for electronic data processing serving commercial purposes which have been ordered from the employer, give instructions with regard to their operation, and maintain or repair them,
- To receive purchased machines, plants and other items or to be instructed in their operation,
- To dismantle purchased used plants for the purpose of re-erection in the country of the employer's head office.

These activities customary in international trade must be announced to the Federal Employment Office prior to the pursuance of the occupation (Section 11 sentence 2 BeschV).

Provision of Services Through Temporary Posting of Workers, Section 15 BeschV

The job administration's approval is not required for the granting of residence titles to foreigners lawfully employed by a company with head offices in a European Union member state or another European Economic Area ("EWR") contracting state in order to provide services and posted to the federal territory only temporarily by their employers for the provision of a service. Previous employment with the posting company is not required.

These persons do not demand access to the German job market but return to their home country after the occupation's termination. This short-term posting makes it possible for foreign companies to realize their business objectives in the Federal Republic of Germany much easier. They can for instance use this residence title in order to prepare a company establishment or another kind of investment or pave the way for new business connections in the Federal Republic of Germany.

IT Experts, Section 27 BeschV

The regulation for the admission to qualified occupations in the IT sector known as "Green Card" has been continued for IT experts. The other elements of the statutory ordinance "IT-ArGV" previously in force have become obsolete as the Immigration Act ("Zuwanderungsgesetz") no longer attaches importance to a person's individual abilities but rather to the foreigner's scheduled qualified or highly qualified occupation.

Gainful Employment with the Federal Employment Office's Approval

If none of the aforementioned exceptions applies, the granting of a residence title requires the Federal Employment Office's approval (Section 39 AufenthG). Within the framework of its own discretionary decision, the employment administration may grant its approval if no adverse effects on the job market result from the foreigner's employment (Section 39 (2) no. 1 a) AufenthG), no German employees or privileged Union citizens are available for employment (Section 39 (2) no. 1 b) AufenthG), and the foreigner is not employed on less favorable terms than comparable German employees are. As far as the Federal Employment Office's approval is necessary for employment, an application either for a visa at a diplomatic representation or for a residence title at the immigration office is sufficient. The employment administration's approval is obtained by the immigration office as a matter of principle and the applicant's cooperation is not necessary.

Each approval for the pursuance of gainful employment is granted by the immigration office with reference to a specific residence title (Section 14 (1) BeschVerfV – "Beschäftigungsverfahrensordnung"). It must be taken into consideration that the approval may be granted for a particular employment relationship only (Section 13 (1) BeschVerfV), ending with the termination of that employment (Section 14 (4) BeschVerfV). Prior to taking up new employment in the German territory a new approval must therefore be obtained from the employment administration.

The following transitional provisions apply to work permits granted before the Residence Act and related statutory instruments came into force:

The approval for the granting of a work permit given to a foreigner before January 1, 2005 continues to be valid as approval for the granting of a residence title (Section 46 (1) BeschV). An employment relationship not subjected to a work permit and taken up until December 31, 2004 is regarded as not subjected to an

approval as of January 1, 2005 (Section 46 (3) BeschV read in conjunction with Section 16 (2) BeschVerfV).

Citizens of Acceding States

There is a special regulation for citizens of the countries acceding to the European Union as of May 1, 2004 and January 1, 2007, respectively. With the accession to the European Union those citizens are basically given the same rights as the citizens of the old member states. Citizens of the states acceding to the European Union in accordance with the Treaty of Accession of April 16, 2003 on the accession of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia to the European Union and the Treaty of Accession of April 25, 2005 on the accession of Bulgaria and Romania to the European Union are given EU work permits (“Arbeitsberechtigung-EU”), provided they have been admitted to the job market in the German territory for an uninterrupted period of a minimum 12 months as of May 1, 2004 or January 1, 2007, respectively, or later. This certificate is helpful in particular for an application with an employer or for customs inspection. This does not apply to foreign citizens posted to the German territory by an employer with head offices situated abroad.

Because of restrictions in the treaties of accession, transitional provisions are in force for certain business sectors (e.g. the construction industry and industrial cleaning). With regard to these sectors the “new” EU citizens’ freedom of movement is restricted (with the exception of nationals of Malta and Cyprus). Labor employment in these sectors may be limited in number (Section 39 (3) BeschV).

Foreigners from acceding states seeking self-employment in the Federal Republic of Germany are excluded from these restrictions. That is why citizens of the new member states may settle in federal territory for the purpose of self-employment without preliminary examination prior to entry.

Approval for Other Employment

In certain cases the immigration offices do not examine if German workers are available and adverse effects on the job market are to be expected.

Citizens of the following countries may be given the approval for a residence title permitting the pursuance of gainful employment without meeting the conditions discussed under item 2 (Section 34 BeschV):

- Andorra
- Australia
- Israel
- Japan
- Canada
- Monaco
- New Zealand

- San Marino
- United States of America

Furthermore, preferential approval may be given to persons posted to Germany for altogether up to 9 months per calendar year by a prefab manufacturer based abroad in order to erect and assemble ordered prefabs and modular houses as well as prefabricated and modular industrial structures manufactured abroad by their employer and for carrying out the necessary installations (Section 35 BeschV). Thus it is made possible for the employer to use his or her own qualified staff for both manufacture and erection. A simplified approval procedure is also in force for the employment of foreigners posted by their employers to federal territory for a period in excess of 3 months in order to erect and assemble machines, plants and programs for electronic data processing ordered from the employer, to give instructions with regard to their operation, to maintain or repair them, or to dismantle acquired used plants for the purpose of re-erection in the country of the employer's head office (Section 36 BeschV). In these cases the application of the priority catalog according to Section 39 (2) AufenthG is waived.

1.5.3 Residence for the Purpose of Self-Employment

A foreigner may also pursue self-employment in the Federal Republic of Germany.

Definition of Self-Employment

Any occupation carried out in person or in the legal form of a company without being subjected to an employer's instructions in either case is regarded as self-employment. The centre of attention is the pursuit of a commercial enterprise in one of the various legal forms. The operation of a commercial business is the independent and generally permitted occupation of certain duration in an economic sector with the intent to realize a profit.

Furthermore managing partners of a non-trading partnership ("GbR"), a general partnership ("OHG") or a limited partnership ("KG"), legal representatives of a juristic person or executives are considered self-employed. Even though members of the supervisory board of a public limited company ("AG") are not self-employed in a conventional sense, they do have extensive authorization for leading a company. Without these persons a company would not have the capacity to act on its own account in commerce. Therefore, these persons are also treated as self-employed, and accordingly, their residence does not require the Federal Employment Office's approval.

In the process of registering a limited liability company ("GmbH") or an AG in the commercial register, the local court typically checks to see whether any foreigner appointed to represent the company and who customarily resides in Germany is in possession of a residence permit that allows self-employment.

Merely having an ownership interest in a business (for example as a silent partner or as a limited partner of a KG) is not generally interpreted as "engaging in occupational activity". This also applies to minority shareholders of a GmbH.

According to case law, foreign owners can be considered self-employed if, for example, they own more than half of the holdings in a company and can exercise decisive influence through the voting process at shareholders' meetings.

Prerequisites for Granting a Residence Permit for the Pursuance of Self-Employment

As far as those persons who are not exempt from the granting of the Federal Employment Office's approval in accordance with the BeschV, the residence title must be applied for at the immigration office. The residence permit is granted if there is an overriding economic interest or a special regional interest, if the occupation is expected to have positive effects on the economy, and if its financing is covered by the applicant's personal capital or a loan commitment (Section 21 (1) sentence 1 AufenthG). This is presumed if at least € 500,000 are invested and at least five jobs are created (Section 21 (1) sentence 2 AufenthG). Considering the complex examination of these criteria, the competent statutory bodies, trade supervisory authorities, public trade associations, and the bodies concerned with the admission to certain professions are to be involved, locally competent with regard to the planned occupation's location, and depending on kind and scale of the planned self-employment (Section 21 (1) sentence 4 AufenthG). The involved authorities' statements are not binding on the immigration office but to be considered within the context of its discretionary decision. However, in practice the immigration office does follow the statements of the authorities involved routinely.

Before the authorities issue their statements they particularly examine the foreigner's nationality, the duration of his or her stay in the Federal Republic of Germany, and whether he or she is married to a German national. They furthermore examine the economic sense of the planned enterprise and its effects on the economy. The approval also depends on the sustainability of the underlying business concept, the foreigner's entrepreneurial experience, the amount of the capital invested, the effects on the employment and training situation, and the contribution to innovation and research (Section 21 (1) sentence 3 AufenthG).

It therefore makes sense to provide the application with as comprehensive statements on the business venture as possible and to include (provisional) agreements if available. The following documents should be presented:

- Business references of important business or trade partners
- Description of the locations where the planned occupation is intended to be carried out (possibly presentation of sale or lease contracts)
- Proof of the financial coverage of the venture (possibly by guarantees or securities in rem)
- Proof of professional and specialist qualifications
- Record of entry into the Register of Craftsmen ("Handwerksrolle") if a skilled trade is carried out
- Documents on the scale of the planned occupation

The immigration office initially grants the residence permit for the duration of a maximum 3 years (Section 21 (4) sentence 1 AufenthG). After this 3-year period a settlement permit can be granted contrary to Section 9 (2) AufenthG if the person concerned has successfully realized the planned occupation and if his or her subsistence is secure, as well as the subsistence of dependents living with the foreigner in a family unit and to whom he or she owes support (Section 21 (4) sentence 2 AufenthG). A foreigner's subsistence is legally defined as secure if he or she is able to support him- or herself including sufficient health insurance coverage without recourse to public resources (Section 2 (3) sentence 1 AufenthG).

1.5.4 Competent Authorities and Procedures

An official permit for residence and gainful occupation is granted to foreigners only upon prior application filed with the competent authority (Section 81 AufenthG). It is therefore necessary to take care that the application is submitted to the competent authority early on as dealing with the applications takes some time. The foreigner is obliged to present the necessary proof of his personal circumstances and other necessary certificates and permits to the authority (Section 82 AufenthG).

Time of Application

Foreigners who are not citizens of the privileged countries require a visa *prior to* entry if their stay in the Federal Republic of Germany takes up more than 3 months or if they want to work in the federal territory (Sections 4 (1), 14 (1) AufenthG). This does not apply to foreigners who are privileged in accordance with Article 1 (2) of the Council Regulation (EC) No. 539/2001 (“Drittländerverordnung”–DrittLVO). Citizens of the countries listed therein are exempt from the compulsory visa requirement for stays not exceeding 3 months. According to Article 4 DrittLVO, exceptions are also possible for holders of diplomatic passports as well as for airplane and ship crews.

According to Section 6 (2) AufenthG, a visa for short-term stays may also be granted for several stays with a validity period of up to 5 years. This occurs on the condition that the residence may not exceed 3 months within each successive 6-month period beginning with the day of initial entry.

The possession of a visa prior to entry is of paramount importance because penal provisions for an offence stipulate a prison sentence of up to 1 year or a fine (Section 95 (1) no. 3 AufenthG).

Nationals of Australia, Israel, Japan, Canada, the Republic of Korea, New Zealand and the United States of America may enter the German territory and stay beyond a short duration without a visa (Section 41 AufenthV–“Aufenthaltsverordnung”). As far as a residence title is necessary, it may be obtained within 3 months in the German territory.

Competence of the Immigration Offices

The immigration offices are responsible for the granting of residence permits (Section 71 AufenthG). Locally competent is the office of the place where the foreigner wants to reside or work. With the revised version of the Residence Act the immigration office is now also responsible for the decision on the pursuance of a gainful occupation in the German territory (so-called “one step government”). This means that – except in the cases of the nationals of acceding states subjected to transitional provisions (see above, Citizens of Acceding States under Sect. 1.5.2) – basically no additional permit for taking up an occupation must be applied for at the local employment offices.

Competence of the German Diplomatic Representations

The immigration office is not the competent authority in cases in which foreigners are required to apply for permits and visas before entering Germany. For handling these cases the Federal Foreign Office (“Auswärtiges Amt”) has authorized diplomatic missions abroad (Section 71 (2) AufenthG).

Such foreign diplomatic representations working out of offices located in the geographic areas abroad where the applicants customarily reside have general power to accept, process, and in many cases make a decision on applications. For example, a Russian who lives in Vienna (as opposed to only temporarily staying in Vienna) must file his or her application with the authorized diplomatic mission abroad serving the Vienna area and not the German embassy in Moscow. If the foreigner applies for a longer stay than 3 months or for permission to engage in occupational activity, the immigration office located in the area of Germany where the foreigner intends to reside must give its approval for the granting of the permit (Section 31 (1) AufenthV). The diplomatic mission abroad nevertheless remains the authority which actually issues the visa.

Foreigners who are from or have their usual residence in a country in which Germany does not maintain an office of diplomatic representation must, according to Section 38 AufenthV, file their application for a residence permit with the Berlin branch of the immigration office because Berlin is the seat of the Federal Foreign Office.

1.6 Economic Activity of Foreign Companies in the Federal Republic of Germany

1.6.1 Free Trade

The business regulatory climate in Germany is strongly influenced by the generally very liberal provisions of the Trade Regulation Act (“Gewerbeordnung”–GewO), particularly by its principle of free trade. According to Section 1 (1) GewO all people

have the legal right to engage in business as long as they do not violate any necessary and lawful exceptions or restrictions that apply to everyone.

1.6.2 Business Activities

Foreign businesses no longer require a special permit in order to operate in Germany. Rather, they are subjected only to those permit and licensing requirements applicable to German businesses (for example, requirements pertaining to real-estate agents, loan/credit brokers, investment brokers, restaurants and hotels). Occasionally Germany makes this equal treatment dependent on reciprocity and grants it to businesses owned by citizens of foreign countries whose governments show German businesses operating there the same courtesy. This reciprocity principle applies, for example, to the cargo-hauling industry.

Regardless of whether a foreign business with no intent to do any actual business in Germany, a dependent branch office (a business without its own bookkeeping system or bank account) or a branch office which is registered in the commercial register is concerned, foreign citizens who live in Germany and work for such businesses as managing directors, board members or representatives with full power of attorney must comply with the requirements described under Sect. 1.5.2 above.

It should further be noted that a foreign business will be regarded as a legal entity in Germany only if

- It is so recognized in the country of its incorporation or establishment and
- Its administrative and business headquarters are located in the country of incorporation and establishment.

Proof of these facts can be provided, for example, in the form of balance sheets, affidavits of certified public accountants, lease contracts and telephone bills.

1.7 Registration of Business Activities

According to Section 14 GewO the enterprise's business activity must be entered in the commercial register of the city or community where the business is located. In order to be registered the following documents must be provided:

- An abstract of the business's foreign commercial registration translated into German or proof of the business's registration in a foreign register comparable to a commercial register
- A document showing the authority of the person registering his or her signature and the legal representation if this authority is not established in the above abstract
- Proof of the location of the business through a lease contract or the written confirmation of the landlord
- Passport

A registration form, available in the commercial register office, must also be completed.

Attachment

Countries on the “privileged list”

Andorra	Malawi
Argentina	Malaysia
Australia as well as Coconut Island, Norfolk Island, Christmas Island	Malta
Belgium	Mexico
Benin	Monaco
Bolivia	Nepal
Brazil	New Zealand including Cook Island, Niue, Todelau
Brunei	Netherlands including Dutch Antilles
Burkina Faso	Niger
Chile	Norway
Costa Rica	Austria
Ivory Coast	Panama
Denmark	Paraguay
Ecuador	Peru
El Salvador	Poland
Finland	Portugal including Macao
France	Sweden

Part IV
Computer Law

Computer Law

M. Karger

1 Protection of Computer Software

1.1 *Applicable German Laws*

As in the United States, the question of how computer software rights can best be protected has long been the subject of debate in Germany. Instead of enacting a specific law designed for software, Germany has followed the lead of the U.S. to a large extent and determined that software rights are to be protected by copyright laws. Assuming certain requirements are met, software is also protected by patent and antitrust laws. Protection of the product name is provided by trademark law, which was amended by the Trademark Act of 1996 (“Markengesetz”).

Although the provisions of these individual areas of law work together to provide quite extensive protection for software, this protection is not without some gaps. The legal interplay of copyright, patent, antitrust and trademark law is complicated and not always easy to understand.

1.1.1 Copyright Law

The most important protection for software is afforded by the German Copyright Act (“Urhebergesetz”). This law was amended in 1993 in order to conform to the European Council Directive of 1991 regarding the legal protection of computer programs. In its amended form, the law ensures that nearly all computer programs that demonstrate a minimum of intellectual creativity are protected. Prior to this amendment, the Federal Court (“Bundesgerichtshof”) had required that software meet stringent criteria before it was entitled to protection. It ruled that only programs demonstrating an especially high degree of creativity were capable of being protected.

Similar to U.S. law, German copyright law protects only the “manifestations” (referred to in German as the “Ausdrucksformen”) of a computer program. The ideas and principles upon which it is based are not protected.

A copyright originates with the creation of the software and expires 70 years after the death of its author. Registration of the copyright is neither necessary for its creation nor its enforcement.

Also, as under U.S. copyright law, owners of copyrights under German law are said to possess a “bundle of rights.” They have the right to copy, revise and distribute the software. Nevertheless, it should be noted that by law there are certain uses that a copyright owner cannot prevent authorized users from making of the program. For example, the authorized user is entitled to make a back-up copy of the program, to test the functions of the program in order to understand the ideas and principles upon which it is based and to undertake measures to correct any mistakes in the program. If certain requirements are met, the user may also perform a *decompilation* of the program (separate it into its distinct parts). The rights granted by law to the authorized users of the program may not be altered by contract. Provisions in licensing contracts which attempt to strip users of their legal rights are void.

The right holder in terms of the German Copyright Act has the exclusive right to authorize or to do

- (1) Any form of distribution of the software itself or of copies
- (2) The permanent as the temporary reproduction of the software in any form
- (3) Any alteration of the software, as translation

Databases are protected under Par. 87a–87e and Par. 4 German Copyright Act.

1.1.2 Patent Law

The criteria which must be met in order for software to be protected under patent law are substantially more difficult to meet than under copyright law. Therefore, relatively few persons or companies apply for the issuance of a patent for their software-related inventions.

Under German law, programs for data-processing systems are clearly not viewed as patentable inventions. However, an invention which otherwise meets the requirements of the patent law is not rendered unpatentable just because one of its parts is a computer program. In this case, the entire invention – including the program – is entitled to a patent. In order to receive a patent, the invention must involve a technology which meets the criterion of originality, be based on inventive activity and be commercially useful.

For instance, patentable are:

- Inventions related to computer programs which change the composition or use of a data-processing system
- or –
- Inventions which relate to the data-processing system’s ability to function and, in doing so, direct the way in which the technical elements of the data-processing program work together

Therefore, the types of computer program-related inventions capable of being patented include operation-system programs, programs which concern measuring and norm technology and programs for the processing of digital pictures or signals.

On the other hand, programs for such tasks as inventory administration, accounting, calculation or word processing are not patentable under German law because they do not demonstrate the requisite technical characteristics.

The right to the invention and the right to be granted a patent belong to the inventor. In order to be granted a patent, the inventor must register the invention with the Patent Office (“Patentamt”): The rights which derive from the patent end with the patent’s expiration date which, as a rule, is 20 years from the date of its issuance. The owner of a patent has an exclusive right to it and can, for example, prohibit another from using the process or the results derived by using the patent.

1.1.3 Trade Secret Protection

Practice has shown that after copyright law, antitrust law is the next most important source of protection for computer software. According to the Unfair Competition Act [“Gesetz gegen den unlauteren Wettbewerb” (UWG)], it is illegal to expropriate the achievement of another

- When that achievement has significant impact on competition
- When it involved considerable costs
- and –
- When such expropriation or take-over amounts to depriving the owner (for example, a software writer) of the fruits of personal labor

Therefore, it is illegal to make copies of computer programs and offer them on the market.

The Unfair Competition Act prohibits the unauthorized exploitation of business and trade secrets. Computer software can represent a protected business secret when the information in the program is not information which is otherwise readily available. This means that the secret contained in the software must be such that other persons do not have access to it or can achieve access to it only with considerable difficulty. In particular, “programming secrets” are protected. Antitrust law thus protects the entire spectrum of confidential technical know-how including the ideas that form the foundation of such know-how. However, to the extent and at the point where the secrets are publicly known, trade secret protection is lost.

1.1.4 Trademark Law

According to the new trademark law which was enacted in 1996, all marks, which are designed to distinguish one product or service from another are capable of being protected. This includes but is not limited to words, pictures, word-and-picture combinations and sounds. In order to be protected, the distinguishing mark must be

registered in the trademark register and actually used in the marketplace. If the trademark is not used for a period of 5 years, it can be challenged. The owner of the trademark has the right to its exclusive use and can, therefore, prevent others from using it. The protection afforded by a trademark registered in Germany extends throughout the entire country and is valid for 10 years from the date of the application filing. The term of protection can be extended for another 10 years by paying an additional fee, and this process can be repeated as often as the owner wishes.

1.2 Applicable European Community Laws

The European Community strives for standardization of the national laws of the Member States that provide protection for computer software rights. In the long run, this standardization will occur in all the areas of law discussed above. Presently, more progress has been made in some areas than in others.

1.2.1 Copyright Law

Although considerable differences exist between the general copyright laws of the Member States, much progress has been made in the specific area of computer software and data-bank protection. A 1991 European Council directive concerning the legal protection of computer programs requires all Member States to bring their laws into compliance with its provisions. Germany incorporated the directive's provisions into its national law in 1993. This directive requires that the Member States adopt certain minimum rules in order that a similar level of computer software protection be achieved throughout the Community. Such minimum rules ensure that the exclusive right of the copyright owner includes the right to prohibit others from copying or revising the software and distributing it to the public. On the other hand, the directive also requires that Member States adopt provisions which ensure that an authorized user has the right to make a back-up copy of the program. It is important to note that certain of the owner's rights arising from the copyright are exhausted upon the sale of a copy of the software program within the European Community.

In March of 1996, the European Parliament and Council passed Directive 96/9/EG, which concerns the protection of data banks. Until 1996, copyright protection for data banks was not available because they were not generally seen as representing the requisite degree of intellectual creativity with respect to the range and arrangement of data. This has changed with the Directive 96/9/EG, which developed an independent protection system for data banks that requires only a certain amount of originality in its compilation.

The German legislation has decided to implement the directive by amending the German Copyright Act. It regulates within a separate section the protection of the data base manufacturer. In principle the same rights as granted to software producers

are applicable. However, the protection of the rights of the data base manufacturer is limited to 15 years.

1.2.2 Patent Law

The European Patent Agreement of 1977 forms the authoritative basis for the European Community patent law. As a result of this agreement, the European Patent Office (“Europäisches Patentamt”) was established in Munich. This office serves as the central administrative agency responsible for conducting the research and investigation necessary for the issuance of a European patent. The patents issued by the European Patent Office are valid throughout Europe from the date of their issuance, and are simultaneously subject to the differing patent laws of the individual Member States. For this reason, one can say that no standard European Community patent currently exists.

The requirements for the granting of a patent according to the European Patent Agreement of 1977 are essentially the same as the requirements for the issuance of a patent under German law. The draft of an EC-patent-directive was rejected by the European Parliament in July 2005. Therefore, a European wide protection of software by patent rights can not be expected in the near future.

1.2.3 Trademark Law

In 1988, the European Council enacted a regulation pertaining to trademarks which resulted in an important change. It established uniform European-wide trademark protection which is effective in all the Member States. European Trademark Law is administered by the European Trademark Office in Alicante, Spain. One can apply for and receive a trademark only for the entire European Community. If issued, the trademark is effective throughout the Community. If declared invalid, it is likewise invalid throughout the Community. The regulations provide a protection time period of 10 years and require that the trademark must be used to remain protected.

2 Procedures in the Event of an Infringement of Software Rights

The owners of computer software are entitled to seek judicial relief if their rights are violated. As in the U.S., it is possible for the owners of software rights in Germany to receive speedy interim relief in the form of a judicial order enjoining an infringement. The application for such a temporary injunction (“einstweilige Verfügung”) does not require the payment of a bond. In the main action, the plaintiff may sue for a final order prohibiting the infringement as well as for damages and the surrender of any property of the defendant that constitutes the infringement.

In many respects, the infringement proceeding in Germany is subject to different civil rules of procedure than those applicable in U.S. legal proceedings. For example, under the German rules of civil procedure, no right to pretrial discovery (as that term is understood in U.S. jurisprudence) exists. The owners of software rights cannot compel defendants to give them evidence of the documents in their possession. As a result, proving an infringement is often difficult, especially in cases in which the plaintiff needs the source code of the other party in order to prove that the original program is identical with the program of the defendant.

Since, in contrast to the U.S. civil process, there is no trial by jury in Germany, all the evidence is reviewed and the legal issues decided by the judge. Whereas the parties' experts play an important role in the U.S., they are of limited importance in determining the outcome of a German court case. If judges are unable to answer technical questions themselves, they call in an independent court expert ("Sachverständiger"), whose opinion, as a rule, is accepted by the Court. The testimony of the parties' own experts is usually given very little weight.

In summary, it can be said that the protection of software rights in Germany is essentially the same as the protection afforded under U.S. law. Nevertheless, many considerable differences exist concerning procedural details. Not all of the well-known principles of U.S. law will be automatically recognized in Germany.

3 Software and Computer Contracts

3.1 *General Principles*

Under German law, the parties are free to determine the terms of their computer software or hardware contract as they see fit. If the contracting party located in Germany is a merchant ("Kaufmann") as that term is clearly defined by law, it is possible to agree that the contract will be governed by U.S. rather than German law. Nevertheless, German contracting parties often are not willing to accept the contracts drafted by U.S. firms.

One doing business with software in Germany must pay attention to several regulations, which are special in this country.

(1) Section 305 subs. of the German Civil Code (Law for the Regulation of General Terms of Business)

In drafting contracts, the "Law for the Regulation of Standard Business Terms" as codified in Section 305 subs. of the German Civil Code (BGB) should be considered.

Certain terms are impermissible in standard form contracts. According to Section 307 BGB, a clause is invalid if it adversely affects the other party.

Such an inappropriately injustice is presumed, if

1. The contract is not compatible with the important basic principles of the law from which it deviates;

2. Or if essential rights or duties, which arise from the nature of the contracts, are limited in a way which would endanger the purpose of the contract.

Section 307 BGB regulates business-to-business contracts as well as business-to-consumer contracts.

In addition to Section 307, Sections 308 and 309 BGB also specify this rule.

They include clauses which, depending on the circumstances, might be or always are invalid. According to Section 310 BGB, these two paragraphs are not directly applicable to business-to-business contracts. But, according to the German Federal Supreme Court, clauses in business-to-business contracts that are similar to clauses in Sections 308 and 309 BGB, indicate that they adversely affect the other party.

However, in business-to-business contracts, there are more possibilities of contract clauses than in business-to-consumer contracts. In cases involving business-to-business contracts, the courts determine the validity of clauses on a case-by-case basis, and consider commercial uses, the overall agreement, and all other circumstances of the entire contract. For more details see the chapter “General Terms of Business”.

(2) Type of contract

German law requires the classification under a certain type of contract. The classification causes important consequences for the regulation of the contract, especially the liability. A standard term software license could either be a sale or a lease contract. According to the German Federal Supreme Court, a standard form software license is considered a sale, if standard software is subject to the contract, the use-right for the software is for an unlimited term and the license fee is an unlimited fee. Contracts, which do not fulfill these three premises are considered a lease.

If the contract is to be subject to German law, particularly in the case of standard contracts or standard-contract terms, care should be taken to ensure compliance with consumer-protection laws. If this is not done, it is possible that certain provisions of the contract could later be deemed invalid. For example, contract clauses which limit or exclude liability are often found to violate consumer-protection laws and are, therefore, declared unenforceable. In such a case, the party that attempted to avoid liability will be declared fully liable.

Software and hardware are subject to German product liability laws. According to these laws, the manufacturer (and under certain circumstances the importer and seller) are liable for defects in the product. This liability cannot be ruled out by contract.

Public authorities (public agencies, hospitals and public utilities) are often willing to accept only certain standard contracts. Such contracts typically give them advantages over the contractor. One often finds these standard contracts or contract terms in contracts for the purchase, rent and servicing of hardware as well as for the development, licensing and maintenance of software.

To the extent that the parties do not expressly address an issue in their contract, the terms of German law, in particular those of the Civil Code (BGB), the Commercial Code (HGB) and the Copyright Act (UrhG) apply. If the parties do not wish to deviate from the provisions of German law, the issue need not

be addressed in the contract, which generally tends to keep German contracts shorter than contracts in the United States.

3.2 Licensing and Distribution Contracts

In drafting licensing or distribution contracts for software, the parties must observe the mandatory antitrust laws. A violation of such laws results in the invalidity of the contract. The Law Against Restraint on Competition (GWB) makes any terms in licensing contracts problematical when they attempt to restrain the use and application of software, prohibit sublicensing and assignment or require the coupling of the software to certain other software programs.

German law does not permit distribution contracts to require independent distributors to enter sublicensing contracts with the end users at specific prices or according to certain conditions. Due to the amendment of the GWB in 1999, it is not necessary any more, that all contracts which contain limiting provisions relating to antitrust law must be in writing.

The European antitrust law is in many respects stricter than the German antitrust law (see chapter “Antitrust Law”). The most important European antitrust provisions are Art. 81 and 82 of the Treaty Establishing the European Community (EC Treaty). Article 81 prohibits agreements between enterprises which prohibit, limit or distort competition within the European Community. Such agreements are unenforceable. A violation of Article 81 can subject the enterprises to heavy fines. According to Art. 81 (3), an enterprise whose contract contains a limitation on competition can apply to the European Commission for an exemption. Although the Commission is empowered to provide exemptions if certain conditions are met, the process is not always practical and often quite drawn out. For that reason the Commission has passed several regulations which exempt certain categories of contracts (“block exemptions”).

With respect to software and hardware, the new European Commission regulation regarding contracts for the transfer of technology (block exemption EC 772/2004), which came into effect on May 1, 2004, should be mentioned. In contrast to the former regulation that removed computer software and hardware contracts from the coverage of block exemptions No. 2349/84 regarding patent licensing agreements and No. 556/89 regarding know-how agreements, the actual regulation on transfer of technology applies explicitly to software license contracts. To be applicable, the contract must refer to a software production due to a special license. In contrast, the typical use of standard software without the right to produce and sell software is not subject to the regulation.

The regulation permits in principle a competition prohibition up to 5 years, a regional sale limitation and the agreement of a minimum license fee. That means that these agreements are not subject to the general prohibition of Art. 81 EC, but are seen as legally valid.

Article 82 also contains significant European antitrust law. It prohibits the abuse of a market-controlling position in the Community to the extent this abuse could have a negative effect on trade between the Member States.

One, who deals with software in Germany must pay attention to several regulations which are special in this country.

Electronic Commerce

R.E. Walch

1 Applicable German Laws

In the world of E-Commerce it is of vital importance for both seller and buyer that closed contracts are legally binding and enforceable. Therefore, the knowledge of the respective applicable German laws and regulations is paramount for both the business-to-business (B2B) and the business-to-consumer (B2C) online distributors.

European Union legislation has induced the enactment of regulations in Germany in order to protect consumers (i.e. individuals dealing with traders) when contracting at a distance. These regulations cover most contracts for goods and services to be supplied to a consumer where the contract is made exclusively by means of distance communication. As part of the reform of the German contract law these dispersed acts and statutory instruments were incorporated into the system of the German Civil Code and can now be seen as the legal framework for all commercial transactions in open data nets.

In addition to the legislation in the German Civil Code (BGB) the Ordinance on the Duty to Provide Information to Consumers (BGB-InfoV) and the Telemedia Act of 2007 (TMG), replacing the Federal Information and Communication Service Act of 1998 (IuKDG), impose obligations on all operators of so-called “telemedia”, electronic information and communication services, which include private and commercial webpages, webshops and blogs, to inform the consumer. Liability and data protection is also within the scope of the Act.

2 German Civil Code (BGB) – Law Pertaining to Contracts

2.1 *Closing of Contracts in Open Nets*

Under German Civil Law a contract is concluded when there is a meeting of minds which means that the offer and its acceptance must come together. This basic rule

for any contract is also applicable for those commercial transactions, which rely on the exchange of electronically transmitted acts by E-mail or mouse click.

The blank order form on a homepage (business-to-business or business-to-consumer) can be seen as the general invitation of the seller to the buyer to accept this offer (“invitation to treat”). By filling out the order form or by simply clicking on the OK-button the consumer accepts this offer and the contract is concluded. In most cases, however, order procedures are organized in a different way. If the seller only generally describes his products on the homepage and expects the customer to place the order then the contract is entered into when the order is finally accepted and confirmed by the seller.

Accordingly, it is also part of each business E-Commerce strategy to ensure the legal validity of business transactions by efficiently designing and organizing such order procedures.

The acceptance of an offer can be either explicit—the order confirmation is sent by mail or E-mail – or implicit by simply delivering the product to the customer.

Both offer and acceptance are binding and can only be retracted or revoked before being accepted (offer) or before reaching the offeree (acceptance).

The acceptance of the offer can be expected in 2–3 days – failure to do so would mean that the contract is not concluded. There is no rule that silence to an offer would mean acceptance except for B2B transactions where there is no need for consumer protection.

2.2 Standard Terms and Conditions

For business-to-consumer transactions in open nets standard terms and conditions (“Allgemeine Geschäftsbedingungen”) are not automatically binding for the consumer but have to be incorporated, which obligates the seller to explicitly refer to its standard terms and conditions and allow the consumer to have access to them. The mere possibility to access them is sufficient, actual knowledge is not necessary. On the other hand electronic standard terms and conditions must be clearly structured and should not be too long because otherwise the detailed adjudication protecting consumers may apply.

Electronic commercial transactions using electronic information and communication services (“Telemédia”) follow different rules since the enactment of an European Directive on E-Commerce. Standard terms and conditions in B2B and B2C must be accessible to customer and consumers at the latest when closing the contract, and the technical means to save them on disc, CDs or hard drive must be ensured.

2.3 Distant Sale Contracts and Electronic Business Transactions

Unlike traditional sale transactions, buyer and seller do not necessarily have physical contact when buying via the internet. As the buyer cannot see and touch the product before buying he or she can easily be deceived about its quality.

Because the buyer and the seller have no personal knowledge of each other and because the product initially only exists in the virtual world, the German legislature implemented an EU directive by way of the Act on Distant Sale Contracts on 30th of June 2000, which is now incorporated into the German Civil Code. Granting a right of revocation and increasing the seller's obligation to inform the buyer before and after the contract have maximized consumer protection.

If applicable, the law protects private consumers insofar as they have – under certain conditions – the right to rescind and ship back the product already bought back.

Such consumer protection is threefold:

- The seller has to fully inform the buyer about the key details of the contract including his right to return the product within 2 weeks
- The seller has to give a written confirmation of all key-information given before closing of the deal
- The buyer has the right to fully and unconditionally return the product with a full money back guarantee within 2 weeks

However, the consumer is only entitled to these benefits if a so-called “Distant Sale of Goods and Services” between consumer and non-consumer (trader) can be identified. Following the legal definition a contract must be prepared and finally closed with the exclusive use of such means of communication which lack simultaneous physical contact: letters, catalogues, telephone calls, facsimiles, E-mails and broadcast-services, tele-services and media-services are examples for such means of communication.

The law does not apply to those tradesmen who have no distant sale distribution structure but only use telephone, telefax or E-mail from time to time for selling their products. It is the seller, however, who has to prove that he does not have such an organized distribution structure.

There are a variety of exemptions for a number of services offered on the online marketplace such as home delivery services, distant learning offers and the sale of real estate. For these services the law does not apply by definition. Financial Services, however, such as banking services, lending, insurance, pension schemes, financial investment and payment are no longer exempt from the law.

The obligation to inform the consumer is detailed in an Ordinance on the Duty to Provide Information to the Consumer (BGB-InfoV). It obligates the seller to reveal the following core details of the contract before placing of an offer (list not complete):

- Name and address of the seller (including company register number and name of legal representative)
- All steps which lead to the closing of the contract
- Net price (tax and other costs included)
- Payment and delivery
- Delivery and shipping costs
- Cancellation of the contract and right to send back the product
- The commercial purpose of the deal

For financial services more detailed pieces of information have to be disclosed beforehand.

These details can be electronically transmitted but need to be clear and understandable for the average consumer.

Once the customer knows all the above details before closing of the contract the same has to be effectively handed out to the customer in written form or confirmed in an E-mail plus additional information as follows:

- Conditions and legal consequences of the cancellation of the contract (including shipment back to the seller)
- Address of the complaint department and the legal address of the seller including the name of one legal representative
- Information on customer services, legal warranties and given guarantees
- Conditions of cancellation of the contract for long-term contracts

The written form (“textual form”) requires that there is a signature (scanned but no digital signature necessary) on the confirmation sent to the customer, which must reach him once but at the latest when the product is shipped. It is no longer sufficient to present the prescribed (compulsory) information on a website before the contract is closed without written confirmation of the same after closing.

The sanctions for not informing the consumer in the described way are considerable:

Infraction of pre-contractual obligations to inform the consumer may lead to damage claims and may also lead to a prolongation of the 2-week revocation period to a maximum of 6 months.

This means that the seller may be exposed to a contract revocation for as long as 6 months, if the buyer changes his mind.

Also, consumer protection agencies can sue the seller for omission of wrong or insufficient information.

The European Directive on Electronic Commerce has considerably extended the scope of required information disclosures. With its transfer into the German Civil Code not only contracts between tradesmen and consumers but also B2B contracts with “customers” have to follow specific rules on the disclosure of information. Only if B2B or B2C contracts for the delivery of goods or services are closed using telemedia (which includes all online shops) the law applies and the seller (trader) has to

- Establish effective technical means which allow the customer to discern operational errors and to correct them before the offer is placed
- Electronically confirm the receipt of the customer’s order without delay
- Inform the customer beforehand about the technical steps which proceed and finally lead to the closing of the contract
- Whether the contractual document is saved by the tradesman after closing and whether it is accessible for the customer
- About the establishment of effective technical means for the correction of operational errors

- About the languages which are available for the transaction
- About the code of conduct or practice which may be applicable or which accepts the tradesman as binding for himself
- Establish technical means for the electronic access to the contract details including the seller's standard terms and conditions and the possibility to save them

The law does not apply if the contract has been closed by E-mail correspondence without the use of telemedia (individual communication) or if customer and seller have agreed on the exclusion of these obligations (only for B2B contracts!). No such exclusion is allowed neither for B2B nor for B2C contracts for the latter of the above duties: The electronic access to the contract details including the seller's standard terms and conditions must be ensured at all times.

Protection of Internet Domain Names

W.C. Leonti and H. Schroeder

This article will first provide an overview of the German domain name registration process. It will then discuss potential legal claims and arbitration procedures against domain name-grabbers. The authors try to find answers for the following questions: What considerations must be taken into account in the German registration process of a domain name? How can a company proceed against someone who has grabbed the desired domain name before the company had a chance to register it? Are there government authorities or organizations providing support?

1 Introduction

Due to the rapid growth of commercial activities on the internet, most companies have rushed to set up their own web sites. First a company must register its own unique electronic address (technically called a “domain name”) so that internet users can find and access the site. However, given the current first-come, first-serve principle for registration of domain names, a serious problem has surfaced: when a company attempts to register its name or trademark as a domain name, it is told that someone else has already registered the domain name. Upon further investigation, the trademark’s rightful owner learns that the registrant is not a bona-fide commercial user of the domain name, but rather is merely a domain name-grabber; that is a person who registers a domain name using a registered trademark before the legitimate trademark owner has had an opportunity to do so in the hope of extracting a quick payoff from the company.

2 Overview of the German Registration System

The Internet is the world’s largest computer network connecting millions of computers worldwide. Each computer can be accessed by an alphanumeric domain name. Domain names in Germany are registered with the DENIC e.G. on a first-come, first-serve basis. The top level domain for Germany is “.de” which is also called a

country-code top level domain (ccTLD). The German registrar usually does not verify the legitimacy of the domain-name registration, but reserves himself the right to refuse the registration in case of obvious infringements of rights. Since each domain name may be assigned only once on a worldwide basis, disputes are inevitable on this front. In the last few years, this problem has been aggravated by the rapid slump in domain-registration prices. Whereas the price for the registration of a .de domain, for instance, was still in the order of € 50 as recently as a few years ago, de domains are now available for as little as 50Cent a month – or even free of charge – from the major resellers. This situation has in particular in Germany led to a veritable torrent of new domain names. Only the international top level domain (TLD) “.com” has more domain names registered than the ccTLD “.de”. Consequently, it is no surprise that it is becoming increasingly difficult to find a suitable domain name for a company’s web site. Generic domain names, i.e. domain names consisting of a general single-word designation and the .de endings, are all but sold out. Even domain names consisting of three or four letters are virtually all taken. Today, the question of whether a suitable domain name is still available is a key issue that must be resolved as early as upon establishment of a company.

2.1 Registration Guidelines

In principle, the prerequisites for domain registration differ from country to country. For the registration of .de domains, German case law has defined among others the following rules:

Rule 1: no brands, no names of other companies

Rule 2: no celebrity names

Rule 3: no titles of magazines, movies, software

Rule 4: no city names, geographic indications of origin or car license-plate numbers

Rule 5: no names of government institutions

Rule 6: no typing-error domains

2.2 Registration Process

Usually, a domain is registered via an internet service provider. The company applies for registration of the desired domain name with the provider, which, in turn, obtains protection of the name from the competent authorities such as DENIC e.G. in Germany for the ccTLD .de, VeriSign Inc for the TLDs .com, .net, .cc and .tv, Eurid for the ccTLD .eu, Afilias Inc. for the TLD .info, Public Interest Registry for the TLD .org or Neulevel Inc. for the TLD .biz. On the internet, you can also search the “whois database” on the registrar’s web site to check whether the desired domain name is still available. You can also apply for registration of your domain name directly with the registrar in your own name. The necessary steps in this process are explained on the registrars web site. In many cases, the costs of direct registration are considerably higher.

2.3 Domain Owner, Admin-c

Make sure that the domain name is secured only in your own name rather than in the provider's name. It frequently happens that providers refuse to release domain names in disputes with their customers because they want to use them as a means of exerting greater pressure on their customers. Besides a third person could try to assert claims against the provider – especially if the provider can't prove that he was registering the domain by order of his customer. By registering a domain in your own name, however, you can avoid these problems. If the domain holder is a company, an individual with an address in Germany must be named as administrative contact (admin-c), at least for .de domains.

3 Domain Name-Grabbing

In principle, a company can take action against any party commercially using its brand name or longstanding business name on the internet. You can also take action against a party registering the company name as an internet domain without being authorized to do so. Operation of a homepage under this name is not necessary. Resourceful profiteers, in particular companies offering web-site design, often secure domains in their own name with a view to forcing companies to contact them under all circumstances. If the companies in question subsequently try to set up a web presence under this domain name, they find that it has already been registered by someone else.

You can initially respond to such behavior by sending the party in question a warning letter. As a rule, this should consist of a written statement in which you clearly state the domain name in question and request deletion of the registration of the domain. You should also indicate why you believe that you are lawfully entitled to this domain name. This written statement should be sent by certified mail, so that you have proof of receipt. Depending on the purpose and scope of utilization of such an Internet domain, the amount in dispute is in the range of € 40,000–50,000 or more. To ensure that the domain name is subsequently actually registered immediately in your name, you should ask the registrar to secure the domain in the event of release until the dispute has been resolved. This is called wait or dispute application.

4 Legal Claims

4.1 Court Litigation

If a warning letter fails to have the desired success, German law offers the possibility of asserting claims to a domain name through litigation. To save time and money, in most of the cases companies apply for an injunction. However, the opponent can defend himself by raising objections against the injunction. In cases of no urgency, companies have to file a suit in the main action. It is only possible to claim deletion

of the registration of the domain. According to the German Federal Court of Justice, there exists no right to claim for transfer of the domain. For this reason, it is absolutely essential to submit the above-mentioned dispute or wait application prior to filing a statement of claim. In this context, a special instrument exists to backorder deleting domains. Companies like pool.com or snapnames offer its customers to search the internet for certain domain names that are released and automatically register them on behalf of the customer.

From a legal perspective, victims of domain grabbing can usually assert claims based on their name-bearing rights, company law, trademark law and competition law.

Litigation is advisable for German .de domains, since an individual's German address for service is usually known. In the case of international domains such as .com, .net and .org, domain grabbers are usually located in a foreign country. In these cases, dispute resolution in accordance with UDRP seems advisable.

4.2 Arbitration Procedure, UDRP

To facilitate resolution of international disputes in particular, the "WIPO Arbitration and Mediation Center", a kind of international arbitration service provider, has created what is known as "Uniform Domain Name Dispute Resolution Policy" (UDRP). The rules laid down in this policy have been authorized by ICANN (Internet Assigned Names and Numbers Authority). So far, the responsibilities of this arbitration center are limited to international top-level domains (TLDs) and only a few ccTLDs (which do not include the German TLD .de). Everyone can have recourse to this center which has established severe rules of procedure to speed up the decisions. The complainant must state that the registered domain name is identical or confusingly similar to the trademark owned by him. Furthermore, the current domain owner does not have an independent right or legitimate interest in respect of the domain name in dispute. Another requirement is that the domain name was registered and is being used in bad faith.

The procedure has already proven its worth in more than 12,000 domain disputes, since it is relatively uncomplicated and fast and relies as much as possible on electronic communications in the handling of the procedure. In the simplest cases, the fee amounts to at least 1,500 USD. If the Arbitration and Mediation Center finds that the domain holder is not entitled to a domain, it orders transfer of the domain to the complainant. The decision of the arbitration panel will then be binding for the respective NIC (Network Information Center).

5 Outlook

One potential approach to alleviating the problem of domain-name scarcity, at least to some extent, is known as "domain-name sharing". By adding an entry index page, several entitled parties can share a domain name; links will take visitors to their

respective web sites. This approach is particularly useful in cases in which two companies from different sectors use identical or similar trademarks or company names.

Prior to domain registration, a company should conduct comprehensive analyses to verify that no other party has overriding rights to the domain name. There is usually a good chance of winning against a domain name-grabber if a company has not only an identical company name, but also a registered trademark. To save time and money, it is advisable to use the WIPO arbitration procedure in particular for international TLDs.

Part V
Procedural Law

Enforcement of Rights and Claims through the Courts and Arbitration Tribunals

R. Nacke

1 Judicial Resolution of Disputes

1.1 Overview of Germany's System of Courts

In comparison to many other countries, the judicial system in Germany is characterized by a relatively large number and variety of courts. The reasons for this are the existence of several appeal levels for nearly every dispute, and the fact that specialized courts have been created to handle certain legal categories of disputes. Besides Civil Court there are labor courts for employment matters, Administrative Courts for disputes with the authorities, Social Courts for disputes concerning social welfare, Financial Courts for disputes with the tax authorities and Patent Courts for patent matters. For civil actions, in which the matter in dispute is € 5,000.00 or less, the Local Court (“Amtsgericht”) has jurisdiction in the first instance and all appeals must be filed in the Regional Court (“Landgericht”). In civil actions in which the matter in dispute exceeds € 5,000.00, original jurisdiction lies with the Regional Court and appellate jurisdiction with the Regional Court of Appeals (“Oberlandesgericht”) and possibly (if the case has general importance or is suitable for further development of the law) with the Federal Supreme Court (“Bundesgerichtshof”).

The deciding panels of some courts do not consist of professional judges only but also of citizens known as lay judges (“Laienrichter”). In Labour Courts proceedings, these judges are recommended by employer and employee organizations. In matters before the Commercial Divisions of the Regional Court, the lay judges are citizens who have been recommended by the Chamber of Industry and Commerce [“Industrie-und Handelskammer” (IHK)]. The input of these lay judges often helps to ensure that the economic background of a case is considered in the decision making process. A preference for arbitration over judicial resolution of a dispute on the basis the court's lack economic or commercial expertise is, therefore, not always justified (see II. below regarding arbitration tribunals).

The highest court in Germany's judicial system is the Federal Constitutional Court (“Bundesverfassungsgericht”). This court is not only empowered to resolve issues submitted to it by one of Germany's states or by the Parliament (“Bundestag”), but also hears appeals from citizens who

- Claim that their constitutional rights have been violated and
- Can show that no other means of protecting of those constitutional rights exist

Also, foreign citizens may have recourse to the Federal Constitutional Court, however, according to the law, this does not apply to foreign juristic persons. Whether an exception applies to juristic persons of an EU-member state is not yet decided.

1.2 Length of Time from Filing of Complaint to Judgement

The time between the filing of complaint and final judgement can vary greatly from case to case. Often, in those lawsuits where particularly the defendant might even prefer a longer process, a final judgement is pronounced in 2 or 3 months, while in other cases in which particularly the plaintiff strongly desires a speedy decision, the process can take years and involve two appellate levels. Significant delays may arise in cases where the court has to decide the lawsuit according to foreign law and with regard to the applicable foreign law has to obtain, e.g. the legal opinion of a foreign expert (Par. 293 Code of Civil Procedure [ZPO]).

Nevertheless, it can be generally said that if a lawsuit involves relatively clear facts, a final judgement can usually be obtained in less than 6 months. On the other hand, in legal disputes which are highly contested, complicated and involve large amounts of money, one cannot usually expect a trial court judgement before expiry of 1 year. However, experience has proven that the time from initiation until conclusion of the judicial process is shorter in Germany than in many other countries.

One reason for this could be the fact that the oral documentary evidence submitted to the court is limited. While in many countries the parties must present the court with all documents and facts which have a relationship to their case, in Germany, each party determines which facts to provide the court and its opposing party. This means that there is no “pre-trial discovery” as that term is understood in the USA.

Moreover, in making its decision, the court must disregard facts which the parties themselves have agreed shall not be considered in resolving their dispute. The court must also accept the truth of any facts presented by one party which the other party has failed to challenge, unless the court has knowledge about the missing correctness of such facts.

This limitation on the amount of oral and documentary information used during litigation leads to a simplification and reduction in time of the judicial process. In addition, it often results in the attorney’s litigation strategy being a deciding factor in how the court resolves a dispute. On the other hand, if the attorney conducts the litigation in a careless or negligent manner, the court, being restricted to decide based on the information supplied by the attorney, often has no choice but to rule against the party represented by such an attorney. Therefore, the attorney shoulders a large responsibility for ensuring that the litigation is properly conducted. Furthermore, the attorney withholding key information which could be decisive on the outcome of the hearing may be excluded from submitting such information at a later stage as the information could be rejected as untimely submission (Par. 296 ZPO).

1.3 Accelerated Relief

Accelerated relief is possible, for example:

- To a certain extent in actions filed with the above mentioned Commercial Division of the Regional Court
- To enforce certain specified types of legal instruments (for example checks, and promissory notes) or
- To initiate a special, largely automatic summary proceeding for debt recovery known as “Mahnverfahren”

This last referenced summary proceeding is conducted primarily through the filing of forms and enables a plaintiff with a monetary uncontested claim to quickly and relatively inexpensively obtain a final judgement. The Local Court for Berlin-Schöneberg generally handles the “Mahnverfahren” brought by foreign claimants; for non foreign claims, the residence or domicile of the claims determines which Local Court has jurisdiction. Those summary proceedings for debt recovery are machined.

In addition, when a plaintiff can show that without accelerated relief a danger of irreparable damage exists, such relief is possible to achieve either through the use of what is known as a “freeze order” (“Arrest”) or through an application for a preliminary injunction. Through such proceedings, the plaintiff can within days or even hours obtain accelerated relief for example in the form of a judicial order prohibiting the defendant from disposing of property or from engaging in certain conduct.

However, it is important to note that accelerated relief through a freeze order or an application for a preliminary injunction will not be granted merely upon a showing that without such relief a debtor would be unable to pay a future judgement; rather, it must be shown that the debtor is attempting or has attempted to conceal property, or that as a result of a criminal offense, there is a suspicion that this could be the case (Par. 917 ZPO). Finally, these procedures are not designed to conclusively determine the respective rights of the parties to a dispute. Only relief of a temporary nature is available, which can, if necessary, be later rescinded. Any seized money or property will not be turned over immediately to the creditor; rather, it will be held in safekeeping until the conclusion of the litigation.

Generally, the initiation of such an “Arrest” proceeding or the application for a preliminary injunction raises the legal costs considerably due to the possibility that the same dispute must be concurrently litigated in two proceedings, with each proceeding affording several levels of appellate review.

An additional way in which accelerated relief may be obtained is through a settlement arranged by the parties’ attorneys in accordance with Par. 1042 ZPO. When certain requirements are met, such a settlement is enforceable just like a judgement of a court. If the debtor fails to pay the amount agreed to in the settlement, settlement can be enforced as described below.

In addition, it is possible for a debtor to declare in a document which has been approved by a German notary that said document is acknowledged as executory

title (Par. 794 Section 1 No. 5 ZPO). This means that the debtor acknowledges that the document is one which justifies execution (see also the chapter “Notaries in Germany”).

Naturally, these last two possibilities can only be used with the debtor’s agreement. For this reason, their use is limited to situations where the parties’ respective legal rights are very clear or where it is provided for by contracts. Particularly in transactions involving the sale of real property or ownership interests in a business, it is usual for the buyer to declare in a notarized sales contract that he acknowledges the document to be subject to enforcement proceedings in case the purchase price not being paid in time.

1.4 Enforcement of Judgements

The enforcement of monetary judgements is undertaken by a sheriff’s officer (“*Gerichtsvollzieher*”) when such enforcement involves the seizure of personal property. However, when the seizure of receivables or real property is involved, the enforcement proceeding must be handled by the court.

Usually, the enforcement procedure can be initiated immediately after the rendering of a judgement, and this is true even if the opposing party has the possibility to appeal the judgement. However, before or immediately following the enforcement, the creditor often must deposit security to cover the time period in which avenues of appeal remain available to the debtor. Usually, the security is in the form of a bank guarantee.

A creditor who is enforcing a claim for money most often attempts to have the debtor’s bank accounts or regular income seized. Another possibility is the attachment of the debtor’s personal or real property. One disadvantage of the enforcement procedure is that the creditor must decide which of these types of assets he wishes to first pursue; pursuing several enforcement measures at the same time is not possible for practical reasons (the original judgement must be presented each time).

If the enforcement procedure is unsuccessful, the creditor can make a motion that the debtor provides a so-called “*Eidesstattliche Versicherung*” (Par. 807, 899 et. seq. ZPO). In such a document, the debtor must verify under oath whether and if so what property he or she possesses. The fact that the debtor has provided an “*Eidesstattliche Versicherung*” is noted in a register maintained by the Local Court which has jurisdiction in the geographical area containing the debtor’s residence or domicile (Par. 915 ZPO).

This register is open to the public. Therefore, its entries typically find their way into the information pages of, for example, credit reporting business of the Chamber of Industry and Commerce. The entry thus results in the debtor having difficulty in continuing his self-employment or employment activity. In this way, the “*Eidesstattliche Versicherung*” places pressure on those debtors to satisfy their debts with borrowed money.

On the other hand, it can also occur that the debtor uses his “Eidesstattliche Versicherung” to fend off his creditors, then obtain employment, for example, in his wife’s business and receive an income which is not subject to attachment. This is possible because although all monthly income of a single person over € 990.00 is subject to attachment (assuming he has no support obligations vis-à-vis his relatives), the amount of income which is not subject to seizure increases depending on the number of persons which the debtor must support. In this way, sometimes a person can enjoy a relatively comfortable standard of living despite his large amount of debt.

Due to multilateral and bilateral international agreements, judgements of foreign courts and arbitration tribunals are, in theory, just as enforceable in Germany as are the judgements of German court and arbitration tribunals. Nevertheless, holders of foreign judgements are first required to obtain an order from a German court confirming the enforceability of the particular foreign judgement (Par. 722 et. seq. ZPO).

Although the judge does not review the underlying factual or legal correctness of the foreign judgement during this German enforcement proceeding, such proceeding usually lasts some weeks and results in additional costs. Moreover, there is always the risk that the foreign judgement will fail to meet German legal requirements and therefore be declared “unenforceable”. For these reasons, in many cases it is advisable (assuming such court is, according to German law, competent to hear the matter) to file the original complaint in the German court.

2 Use of Arbitration Tribunals or Mediation

2.1 *Proceedings to Resolve Disputes*

It is becoming more and more common in commercial disputes to turn to arbitration tribunals rather than to the courts. Parties sometimes use the arbitration services of the Arbitration Tribunal of the International Chamber of Commerce in Paris. However, usually they submit their disputes to arbitrators who have been appointed by one of the following:

- The local Chamber of Industry and Commerce
- Appellate judges (for example, the Chief of the Regional Court of Appeals for a particular city) or
- Organizations such as the “German Arbitration Institute” in Cologne or the “German Arbitration Committee” in Bonn

The reasons that parties often agree to arbitration of potential future disputes include cost and time savings as well as the greater confidentiality which an arbitration process affords (unlike a court hearing, an arbitration hearing usually is closed for the public). However, the fact of the matter is that the first objective is often not realized. Once an actual dispute arises, parties frequently spend much time debating

whether the dispute is of the type they initially agreed to submit to arbitration and/or arguing over the choice of an arbitrator.

Often disputes arise about the effectiveness of an arbitration agreement. The arbitration agreement is only legally effective if stipulated in either a document signed by both parties or in a letter, a telecopy, etc. which was exchanged between the parties. As a rule among merchants an arbitration agreement agreed upon orally is sufficient if one party confirms the arbitration agreement to the other party and the silence of the other party is deemed to be acceptance of the agreement (commercial confirmation letter) (Par. 1031 Par. 2 ZPO). However, if a consumer is involved in the agreement, even a separate document has to be issued which contains nothing else but the arbitration agreement only.

The parties can also find themselves disappointed by the costs of the arbitration process. Because many arbitration agreements specify the appointment of a decision-making panel comprised of three arbitrators, the costs of the arbitration process (particularly in the case of disputes involving relatively low monetary values) can be higher than court costs.

However, the point here is not to dissuade parties from entering into arbitration agreements but rather to emphasize the importance of exercising great care in the drafting of such agreements. If this is done, arbitration often remains a more efficient, satisfactory and cost saving dispute resolution method than the courts.

Once the hurdle to appoint an arbitrator is taken, then the further proceeding should be processed in a timely manner. After each party has submitted one or at most two written statements, the court will schedule the hearing. During the oral hearing and with the assistance of the arbitration tribunal, in most of the cases it comes to an agreement between the parties. The parties are aware of the fact that in an arbitration procedure there is no second instance (Par. 1055 ZPO) and furthermore a review of an arbitration procedure decision by a public court is only possible to a very limited extent.

Whether the parties agree on an arbitral award with the assistance of the arbitration court, or the arbitration court renders an arbitral award based on the results of the arbitration proceeding, in both cases the arbitral award has the effect of a final judgement for both parties (Par. 1055 ZPO). This means in principle it is not subject to an appeal and—after being declared enforceable by the Regional Court (OLG)—it can be basis for enforcement just like a judgement rendered by the state court. However, the unsuccessful party may file an application at the competent Higher Regional Court (OLG) for annulment of the arbitral award. This application has only chances of success if certain sound reasons do exist as listed in Par. 1059 ZPO. For the annulment it is not sufficient cause that the matter, according to applicable law, has been decided incorrect. There must have been elementary mistakes in the procedure or the award must be in breach of German *ordre public*.

Last but not least, it should be mentioned that mediation procedures are increasingly becoming the basis of settlement of disputes between parties, in Germany as well. For example, three mediators on request of Bundesland Hessen achieved a settlement of the dispute concerning another runway at Frankfurt airport. The parties were the company running the airport, the city of Frankfurt, environmental

organizations, etc. This mediation procedure among others shows that not only companies but also politicians have detected the advantages of mediation.

A considerable number of organizations offer courses to lawyers and other future mediators. In the event of need they also appoint mediators when called upon and have published codes of procedure in this regard.

However, one always has to bear in mind the essential distinction between lawsuits handled by state courts or arbitration tribunals on one hand and mediation on the other. The purpose of a mediation procedure is to solve a conflict. This is also a task of an arbitration tribunal and of the state courts. However, both these tribunals also have the possibility and the task to pronounce a judgement which can be executed if their efforts to reach a settlement fail. The mediator has no such alternative. This means that if the mediation procedure is chosen for the wrong case, the parties get “stones instead of bread”. After finalization of the mediation procedure, the plaintiff has to start a new procedure, namely a lawsuit, in order to solve the problem.

Nevertheless, in the right cases, the mediation procedure is an excellent tool for solving conflicts in a way that the parties can continue working together after completion of the procedure.

Principles of the Legal Regulation of Attorney Fees

S. Sandrock

Attorney fees in Germany are generally regulated on the basis of a client–attorney contract, which is normally a contract for services (*Dienstvertrag* in the form of a *Geschäftsbesorgungsvertrag*), as defined by Section 675 of the German Civil Code [*Bürgerliches Gesetzbuch* (BGB)]. Client obligation to provide remuneration is thus generally derived from Section 611 BGB. That provision, however, does not regulate the amount of the remuneration to be made in any particular case – the amount itself is determined by Section 612, sentence 2 BGB in conjunction with the Attorney Remuneration Ordinance [*Rechtsanwaltsvergütungsgesetz* (RVG)]. The amount of the remuneration (fees and expenses) is thus determined either on the basis of a client–attorney agreement or in accordance with Section 2, sentence 2 RVG and its attached list of itemized fees (supplement 1 to Section 2, sentence 2 RVG).

1 Obligation to Provide Advance Information Concerning Costs

German law does not hold attorneys responsible for informing their clients, in advance and without having been specifically asked, that a law exists in Germany for the regulation of attorney remuneration (RVG), nor does it hold them responsible for telling them in advance what the costs of the legal action will amount to. There are, however, two exceptions to this general rule. Section 49 b, sentence 5 of the Rules and Regulations of the German Bar [*Bundesrechtsanwaltsordnung* (BRAO)] states that attorneys must inform their clients before taking on the case if their fees are to be set according to Section 2, Section 1 RVG, or, in other words, according to the amount in dispute. In cases involving client representation in labor law proceedings, attorneys must inform their clients before taking on the matter that Section 12 a sentence 1, item 1 of the Code of Labor Procedure [*Arbeitsgerichtsgesetz* (ArbGG)] – as opposed to Sections 91 ff. of the Code of Civil Procedure [*Zivilprozessordnung* (ZPO)] – does not provide attorneys with any compensation for victories attained by way of judgment in the initial proceedings.

2 Remuneration Agreements

Section 4 of the Attorney Remuneration Ordinance (RVG) opens the possibility of setting attorney fees on the basis of agreement. Agreements of this nature will achieve special significance as of July 1, 2006, when a new law will go into effect. Article 5 of the Legal Costs Modification Act (KostRMoG) will provide for an almost complete deregulation of out-of-court costs. Instead of relying on statutory provisions, attorneys will be encouraged to enter remuneration agreements with their clients for all out-of-court counselling and appraisal services (Section 34, sentence 1 RVG 2006). In drafting such agreements there are three points that especially deserve attention:

2.1 Lower Attorney Fees

According to Section 4, sentence 1 of the Attorney Remuneration Ordinance (RVG), it is explicitly permissible to agree on fees that are higher than the ones set by law. If the remuneration agreed to is unreasonably high, however, it can be contested in court (Section 4, sentence 4 RVG), in which case an appraisal is obtained from the bar association and the attorney fee subsequently adjusted downwards in accordance with it. The wording of Section 4, sentence 1 of the Attorney Remuneration Ordinance (RVG), which grants the possibility of agreeing to “a fee *higher* than the statutory fee,” in conjunction with Section 49 b, sentence 1 of the Rules and Regulations of the German Bar (BRAO) makes it clear that it is not allowed to agree to fees for any legal services that are lower than those set by law, or that are contained in the Attorney Remuneration Ordinance (RVG), the intention of that being the prevention of price wars among attorneys and thus the conservation of integrity in the practice of law. Section 4, sentence 2 of the Attorney Remuneration Ordinance (RVG) provides for only two exceptions to this prohibition: out-of-court matters and debt collection.

2.2 Contingent Fees (*Erfolgshonorar*)

As opposed to American law, German law prohibits contingent fees, even in private client–attorney remuneration agreements. Section 49 b, sentence 2, item 1 of the Rules and Regulations of the German Bar (BRAO) explicitly prohibits any agreements that make remuneration of attorney fees contingent upon success or that promise the attorney a certain portion of the money received through successful litigation or settlement as compensation for his services (*quota litis*). The actual form of the agreement is of little significance. All that matters in determining whether or not it is legal and valid is the intention of the parties. It is illegal, and consequently invalid, if it is clear that the intention of the parties was to make remuneration for

the services provided dependent upon the outcome of the matter. It would similarly be an offense against Section 49 b, sentence 2, item 1 BRAO to agree to reimbursement of a part of the attorney fee in the event that the case is lost. German laws regulating attorney remuneration furthermore do not allow agreements in which client and attorney state that the agreements shall be governed by the law of some foreign country that does allow contingent fees.

The new regulation of Section 49 b, sentence 2, item 2 BRAO, however, does not restrict lawyers from entering into remuneration agreements with their clients that contain contingent provisions for higher compensation than the standard amounts provided for by law (RVG). This does not constitute an overruling of the fundamental prohibition of making attorney remuneration contingent upon the successful outcome of the case but simply amounts to a loosening of the very tight restrictions: anytime lawmakers have decided that success-contingent components can be built into the calculation of certain attorney fees and such provisions have been incorporated into the Attorney Remuneration Ordinance (RVG), any agreements to that effect are, accordingly, legal and valid. This regulation under Section 49 b Section 2 BRAO, however, will only apply without restriction until June 30, 2008. On June 12, 2006 the German Constitutional Court ruled in its decision No. 1 BvR 2576/04 that a general prohibition of contingency fees is not reasonable and appropriate in every case. This applies particularly to cases in which the financial situation of the parties seeking legal aid is such that they would not have access to it without the possibility of agreeing with their attorneys that their remuneration be contingent upon their success. The Constitutional Court has therefore instructed lawmakers to pass a new regulation in conformity with the Constitution by the end of the second quarter of 2008 that would permit client–attorney contingency-fee agreements at least in such exceptional cases. At the time of this writing, a regulation to that effect is available only in draft form – according to it, such contracts can be concluded only by way of exception in individual cases in which justice can be done to the special circumstances of the matter only by allowing such contingency agreements. Once such case provided for by the drafted bill is one in which the client, upon reasonable consideration of the matter, would otherwise be prevented from asserting his legal rights by his financial situation.

Above and beyond that, it is also possible to agree to an increase in fees once the matter has been settled, since in that case the additional compensation was not “contingent” upon its successful outcome.

2.3 *Written Form*

Section 4, sentence 1, item 1 of the Attorney Remuneration Ordinance (RVG) provides that anytime parties agree to a remuneration that exceeds the statutory amount, the client must sign a written statement to that effect. It is important to note that a statement of this kind cannot simply be included in power of attorneys, as clients generally do not tend to read them or at least not with the necessary care as to their exact wording. An offense against this provision makes the entire remuneration

agreement invalid and, as a consequence, the client can only be held responsible for payment of the attorney fees foreseen by law. However, Section 4, sentence 1, item 1 RVG also contains a provision for simple natural obligation: in cases in which the attorney is not entitled to higher compensation but demands it and the client voluntarily pays the higher amount without reservation, the client cannot later turn around and demand reimbursement of the remuneration by claiming that it constituted an offense against Section 4, sentence 1, item 1 RVG.

3 Statutory Remuneration

The Attorney Remuneration Ordinance is divided into two parts. The first part [*Rechtsanwaltsvergütungsgesetz* (RVG)] contains the statutes, and the second part [*Vergütungsverzeichnis* (VV)] contains supplements itemizing the fees for legal services. Whereas the first part contains general and even very basic provisions, it does not regulate the actual costs of legal services. Section 2, sentence 2 RVG refers to the supplementary remuneration lists attached to the RVG as attachment 1. Those lists systematically itemize each of the fees that can be charged for particular legal services and set the amounts that can additionally be billed as expenses.

The remuneration system of the RVG is characterized by the principle of “one flat fee for total coverage” of any particular service as catalogued. Under Section 15, sentence 1 RVG the attorney fees listed in the supplement are to be viewed as covering the entire spectrum of activities undertaken by the attorney from the moment he is hired until the matter has been finished.

Example: If a lawyer is hired to represent a client in court in a civil lawsuit being tried for the first time (non-appellate court), all of his activities will be covered by Litigation Fee No. 3100 (*Verfahrensgebühr No. 3100 VV*) as listed in the supplement to the Attorney Remuneration Ordinance (RVG), or in the second part of the same (VV), which contains the list of attorney fees and expenses. That is to say that not only the gathering of information and the drafting of the complaint is covered by Litigation Fee No. 3100 VV but also any and all further activities that are necessary to properly represent the case in court completely independent of the amount of work and effort involved. An additional fee can be charged only if and when such is explicitly provided for. If a lawyer represents his client in an appointment with a third party, for instance, an additional fee is due: Appointment Fee, No. 3104 VV (*Terminsgebühr No. 3104 VV*) – and this, in turn, completely independent of the duration of the meeting.

Considering sentence one of Section 15 RVG together with sentence two, it can be seen that the intention is to make sure that attorney fees are only charged once for each legal service and that multiple billing is avoided. That is to say that each of the legal services catalogued can only be billed once, no matter how often those particular services are repeated or how much time and effort they involve.

Example: Even if an attorney has made many out-of-court attempts to reach a settlement in the first round of a civil lawsuit, scheduling numerous appointments with third parties in the process, he is nonetheless only able to charge the fee for appointments with third parties, Fee No. 3104 VV (*Terminsgebühr No. 3104 VV*), once.

This principle of non-duplication of costs remains in effect, according to Section 15 sentence 5 RVG, even if the matter has been closed or dropped for the time being and the attorney is hired to resume it, the very same legal matter, again within a period of 2 years.

3.1 *The Legal Matter*

Since the designation “the same legal matter” restricts attorney fees to one flat fee for full coverage of everything involved in it from the moment the attorney is hired until the day the case is terminated, the determination of its exact meaning has received considerable attention. It can be very difficult to concretely define what constitutes a single legal matter in cases that are handled out of court, since there is no legal regulation. There are, however, some criteria that can be used on a case-to-case basis to determine whether the various activities of a lawyer can be seen as having been performed in the same legal matter or in various different matters. The decision will depend on

- Whether or not the matters were covered by a single power of attorney
- There is an inherent linkage between them and
- The attorney’s activities occur within the same contextual framework

Example: If a lawyer is hired by a landlord to enforce payment of overdue rent that has accumulated over a period of several months, this would amount to a single legal matter. It can, however, be assumed that in contrast to such a case, we would be dealing with two different legal matters if the lawyer were initially hired just to collect overdue rent for the month of March and, once that payment had been received, were hired again to collect the rent that had become overdue for April.

Example: If, however, a lawyer is hired by a tradesman to enforce payment of two different invoices for services performed for two different customers, we are clearly dealing with two different cases. Although the tradesman only issued one power of attorney covering both matters, there is no inner linkage between the two invoices and the services performed.

Thus a single legal matter exists only when all of the above criteria have been fulfilled and only then does it appear justified to group the closely related activities performed by the attorney together in a single billing item in terms of the principle of total flat-fee coverage.

The situation is different in cases that are dealt with in the public sector or in court. Sections 16ff. of the Attorney Remuneration Ordinance (RVG) contain a very detailed explanation of what constitutes single, different and special legal matters. In Section 16 RVG certain activities are assigned to the same legal matter. For instance, proceedings involving a petition for an interlocutory injunction and later proceedings for alteration or reversal of the same petition, according to Section 16 No. 6 RVG, are to be considered as comprising one legal matter. On the other hand and by way of completion, Section 17 RVG contains a list of cases that despite their close procedural relationship can be billed separately. Section 17 No. RVG, for

example, makes it clear that an administrative procedure, the preliminary procedure that follows the filing an objection and the subsequent proceedings in the administrative court are three different legal matters.

3.2 *Types of Attorney Fees*

The Attorney Remuneration Ordinance (RVG) provides for two different types of fees: fees based on the monetary value of the case (*Wertgebühren*, Section 13 RVG) and lump-sum fees with an upper and lower limit (*Rahmengebühren*, Section 14 RVG). Section 14, sentence 1 RVG provides that, insofar as the RVG contains no regulations to the contrary, attorney fees are to be determined according to the value of the subject matter that is the object of the attorney's activities ("value of the subject matter," *Gegenstandswert*).

3.2.1 Fees Based on Subject-Matter Value (*Wertgebühr*)

When calculating the exact amount of value-based fees, one first has to determine how much the subject matter of the case is worth in terms of its material value. Regulations for calculating that value are contained in Sections 22 ff. RVG. In court proceedings, according to Section 23, sentence 1 RVG, the same regulations used in determining the value of the object of litigation in order to figure the amount of the court costs are also to be used in determining the amount of the attorney fees. If the court has fixed the value of the subject matter, according to Section 32, sentence 1 RVG, that same amount is to be used by the attorneys in calculating their fees. Out-of-court proceedings are likewise to be billed according to the regulations for in-court proceedings if the activity could become an object of litigation (Section 23, sentence 1, item 3 RVG), otherwise according to the provisions of the Ex-Parte Cost Regulation (*Kostenordnung*, KostO) as foreseen in Section 23, sentence 3, item 1 RVG. In the event that the Cost Regulation does not provide an exact calculation guideline either, Section 23 sentence 3, item 2 RVG instructs the attorney to use his own better judgement. A prerequisite for the use of one's own better judgment in the decision-making process is the availability of enough criteria to form a solid opinion. If sufficient criteria is lacking, the attorney is instructed to proceed on the assumption that the subject matter has a value of € 4,000.

Example: A lawyer is hired to enforce payment of a claim in the amount of € 12,000. Once the lawyer has become involved, the debtor pays off the claim. There were no court proceedings. Section 23, sentence 1, item 3 RVG refers to the Court Costs Act (*Gerichtskostengesetz*, GKG). But since there is no regulation there that can be used in this case, Section 48, sentence 1, item 1 of the GKG gives us a further reference to the Civil Procedure Code (*Zivilprozessordnung*, ZPO). Section 3 ZPO states that the value of the subject matter is identical to the amount of the claim, or € 12,000. That value is not altered by the fact that

the attorney was also instructed by the client to collect the interest that had accumulated on the debt. The interest is a subsidiary claim and Section 43, sentence 1 GKG states that such claims are not to be taken into consideration when calculating the subject-matter value.

Example: A lawyer drafts a service contract for a client that foresees monthly payments of € 3,000 for the services to be rendered. For such cases Section 23, sentence 3, item 1 RVG refers us to Section 25, sentence 2 KostO, which states that the value of the subject matter is the total amount of the payments to be received throughout the duration of the contract – but to a maximum of 3 years. In this case, the value of the subject matter is thus € 108,000.00.

Once the value of the subject matter has been determined in this fashion, the amounts of the relevant attorney fees can be determined in accordance with Section 13 RVG in conjunction with the fee scale (attachment 2 to Section 13, sentence 1 RVG). The amount of the fee rises proportionate to the value of the subject matter in digressive steps. The higher the value of the subject matter rises, the less increase there is in the corresponding attorney fee.

Example: The basic attorney fee for a subject-matter value of € 12,000 amounts to € 526.00. For a subject-matter value of € 108,000.00, the basic attorney fee € 1,354.00, and not by any means nine times € 526.00.

In a final step the basic attorney fee is then multiplied by the rate associated with the particular case matter (rate of charges, *Gebührensatz*). The result is the concrete amount of the remuneration that the attorney will receive for his activity.

Example: A lawyer is hired to enforce payment of a claim amounting to € 12,000 by taking the matter to a civil court. He is thus entitled to a litigation fee (*Verfahrensgebühr*) as per No. 3100 VV. Under this regulation the attorney generally receives a fee for court proceedings at the rate of 1.3. With a basic fee amount of € 526.00, the concrete amount in this particular case would thus be 1.3 times € 526.00, or a total of € 683.80.

Even in the case of fees that are based on the value of the subject matter, it sometimes happens that the law does not provide for a set fee rate but rather for a fee range with an upper and lower limit. This holds especially true for the general fee for out-of-court work (*Geschäftsgebühr*) as per No. 2400 VV, which provides for a range in the fee rate starting at 0.5 and going to 2.5. In such cases the lawyer determines which rate to apply using his best judgment and taking the criteria of Section 14, sentence 1 RVG in conjunction with Section 315 of the German Civil Code (*Bürgerliches Gesetzbuch*, BGB) into due account. Here it is general practice to proceed from the assumption of an average rate, which amounts to a fee for out-of-court work at the rate of 1.5 times the basic fee rate, and then to adjust that rate upward or downward depending on the particular circumstances of the individual case.

3.2.2 Fee Range (*Rahmengebühr*)

Attorney remuneration statutes allow for the calculation of certain fees within a semi-flexible range, limited by a minimum and maximum rate. Here again it is up

to the attorneys to use their own discretion in determining the adequate rate while taking the criteria of Section 14 RVG into consideration.

3.3 *Single Service-Based Fees*

The catalogue of fees for legal services (*Vergütungsverzeichnis*, VV) is divided into seven parts containing an itemization of each of the different services and the corresponding fee. The fees based on subject-matter value are listed at set rates or they are assigned a rate range. Part 1 of the catalogue is dedicated to the general fees that apply to virtually all legal matters. Part 2 deals with representation out of court and part 3 with activities involving litigation with the exception of criminal and misdemeanor cases and other special proceedings, which are in turn dealt with in terms of the special regulations contained in parts 4, 5 and 6 VV.

3.3.1 **General Fees**

As the first preliminary remark to the catalogue of fees for legal services (VV) notes, the general fees are applicable in addition to the specific fees listed in the remaining sections. Of special importance among the general fees is the so-called “settlement fee” (*Einigungsgebühr*, No. 1000 VV), which comes into being when the parties have ended their dispute through a settlement in which the attorney has been involved. The basic rate of the settlement fee is 1.5. If court proceedings are already pending, however, it is reduced to 1.3 or 1.0. The subject-matter value that is used to calculate the monetary amount of the fee is the value of the claims that form the object of the settlement.

Example: A lawyer is hired to collect payment of a claim in the amount of € 12,000 out of court. Negotiations follow, which lead to an out-of-court settlement. That gives rise to an attorney fee at the rate of 1.5 times the amount of the basic settlement fee (No. 1000 VV) against a case value of € 12,000.00, or a total of € 789.00.

Example: The lawyer files a complaint in the local court for enforcement of the payment of the € 12,000.00. Before the first hearing takes place, the parties reach a settlement in the amount of € 3,500.00. Here the 1.3 fee for court proceedings (*Verfahrensgebühr*, No. 3100 VV) applies as well as the settlement fee (No. 1003 VV). Because of this double application, the settlement fee is billed at the minimum rate of 1.0. Hence the amount of the attorney fee is € 683.80 + € 526.00, or a total of € 1,209.80.

If, however, the agreement among the parties is limited to a mere recognition of the debt or a waiving of the claim, no settlement fee is to be charged.

3.3.2 **Out-of-Court Representation**

Activities of the lawyer that are performed out of court are regulated in nos. 2100 ff. of the catalogue of attorney fees (VV). No. 2400 VV grants the lawyer a fee for

out-of-court work (*Geschäftsgebühr*) in the range of 0.5–2.5, which includes information gathering as well as involvement in the drafting of a contract (preliminary remark 2.4, sentence 3 VV). The average fee in this case would be 1.5 ($0.5 + 2.5 = 3 \div 2 = 1.5$). A higher fee rate than 1.3, however, can be applied only if and when the involvement of the attorney is very extensive and/or the matter is extraordinarily complex.

Example: A lawyer is hired by a wealthy client to take care of a matter that is of extreme importance to the client. Taking these circumstances into account, the lawyer could charge more than the average rate for his out-of-court services. If, however, his activities are neither extensive nor do they involve considerable difficulty, the cut-off mark for the out-of-court fee is just 1.3 times the basic rate.

If, pursuant to the out-of-court work, the lawyer continues to represent the client in court proceedings, an additional fee is charged: the fee for in-court proceedings No. 3100 VV (*Verfahrensgebühr*). Preliminary remark No. 3, sentence 4 VV determines when the fee for out-of-court work is to be credited against the fee for in-court proceedings. A preliminary requirement for such an off-setting is an inherent connection between the two types of activity. Whenever such a connection exists, the fee for out-of-court work is added to the fee for in-court proceedings at half the basic fee rate (0.5) or at a maximum rate of 0.75.

Example: A lawyer is hired to conduct out-of-court settlement negotiations for a claim in the amount of 5,000 in a matter that is neither complex nor involves a lot of work and effort. After all attempts to settle the matter out of court fail, the client empowers the attorney to take the case to court. The matter is settled, however, before the attorney has filed the complaint. This gives rise to the following attorney fees:

(1) 1.3 fee for out-of-court services (No. 2400 VV) at a case value of € 5,000.00	€ 391.30
(2) 0.8 fee for court proceedings (Nos. 3100 and 3101 VV) at a case value of € 5,000.00	€ 240.80
(3) Subtotal	€ 632.10
(4) Minus one half of the out-of-court fee	– € 195.65
(5) Remaining total	€ 436.45

Example: In the above case the attorney's out-of-court work was very extensive and justifies charging a fee rate of 1.8. His bill of fees will hence be calculated as follows:

(1) 1.8 fee for out-of-court services (No. 2400 VV) at a case value of € 5,000.00	€ 541.80
(2) 0.8 fee for court proceedings (Nos. 3100 and 3101 VV) at a case value of € 5,000.00	€ 240.80
(3) Subtotal	€ 782.60
(4) Minus one half of the out-of-court fee (or, at the most, leaving a maximum fee charge of 0.75)	– € 225.75
(5) Remaining total	€ 556.85

3.3.3 Court Proceedings According to Part 3 VV

The fees listed in the third part of the catalogue of attorney fees (VV) cover the activities undertaken in all kinds of court proceedings with the exception of criminal and misdemeanor cases and the miscellaneous other special types of court proceedings dealt with in the sixth part of the VV. The RVG provides for two basic types of lawyer fees for representation in court proceedings. The fee for in-court proceedings as per No. 3100 VV (*Verfahrensgebühr*) is charged for all of the work done, including the gathering of information, in a court case. The fee generally amounts to 1.3 times the basic rate and becomes due as soon as the first activity included in this section of the remuneration laws has been undertaken, which usually consists of gathering the information necessary to complete his specific assignment. Whenever the circumstances listed in No. 3101 VV are present, however, only a 0.8 fee can be charged. This is particularly the case when the matter is settled before the attorney has submitted the complaint.

Example: The lawyer drafts a complaint to enforce payment of a € 5,000.00 claim, as his client has instructed him to do. Before he can submit the claim, however, his client informs him that the debtor has meanwhile balanced the account. In this case the lawyer can only charge a 0.8 share of the fee (Nos. 3000 and 3001, No. 1 VV), which amounts to € 240.80.

In addition, an appointment fee (*Terminsgebühr*) as per No. 3104 VV can arise in court proceedings, which is usually billed at the rate of 1.2. Only in the cases regulated by No. 3105 VV is the appointment fee set at the lower rate of 0.5. Such is the case, for example, whenever the attorney simply submits a petition for a judgment by default in court hearing to which the defendant does not appear. The fees for court proceedings and appointments are regulated in the same way for appellate proceedings in the next higher court (*Berufungsverfahren*) and special appellate proceedings to overrule a judgment on technical grounds (*Revisionsverfahren*). The only difference is an increase in the rates. In *Berufungsverfahren* the attorney receives a 1.6 share of the fee for court proceedings and a 1.2 share of the appointment fee. In *Revisionsverfahren* he receives a 2.3 share of the fee for court proceedings and a 1.5 share of the appointment fee.

3.3.4 Expenses

Part 7 of the catalogue of attorney fees (VV) grants the lawyer the right to charge reimbursement for his expenses in addition to the regular fees. No. 7000 VV provides for a flat-rate reimbursement of documentation costs and No. 7001 VV for reimbursement of the total amount of all postage and telecommunication costs. Alternatively, No. 7002 VV allows for billing the costs of postage and telecommunication at the rate of 20% of the attorney fee up to a maximum amount of € 20. Under No. 7008 the lawyer can furthermore demand payment of the full amount of sales tax added to his fees and expenses – as long as there is no cause for tax exemption under Section 19, sentence 1 of the VAT Act (*Umsatzsteuergesetz*, UStG).

4 Payment of Fees

Section 9 RVG grants the lawyer the right to demand a reasonable fee advancement of his client in the preliminary stages of the legal process to cover the fees and expenses that can be expected to arise in the matter. Payment is due upon termination of the case (Section 8, sentence 1 RVG). According to Section 10, sentence 1 RVG the lawyer can demand payment only in the form of a formal invoice addressed to his client. Section 10 RVG and Section 14, sentence 4 UStG stipulate that the invoice must include the following statements:

- The value of the subject matter and the fees that are based on it
- Brief designation of the service item being charged
- The corresponding number of the catalogue of attorney fees (VV)
- The individual amounts of each of the fees and expenses
- The amount of advance payments received
- The attorney's tax number or VAT identification number
- A sequential invoice number, which has only been assigned once
- The signature of the attorney

If the invoice does not fulfill all of the formal criteria contained in Section 10 RVG, the client still has the obligation to pay it, even though payment cannot be enforced through court proceedings.

Notaries in Germany

C.R. Wolf

1 Legal Status of the Notary

1.1 Independent Holder of Public Office

The German notary is an independent holder of public office responsible for recording legal transactions (Par. 1 of The National Rules and Regulations for German Notaries [“Bundesnotarordnung” (BNotO)]. As opposed to attorneys, notaries are not members of the free professions but rather the agents of state authority. On the other hand, notaries are not civil servants either, but are independent holders of public office not subject to any personal orders or subject-matter-related instructions.

The status of the notary as the holder of public office precludes the free right to set up practice. Instead, the German states appoint only as many notaries as are necessary to ensure the regulated administration of justice (Par. 4, Sentence 1 BNotO). Thus, even if candidates can prove professional qualification, they have no lawful claim to be endowed with the notary office.

1.2 Types of Notary Offices in Germany

In Germany, there are basically two different types of notary offices. In the federal states of Bavaria, Hamburg, Mecklenburg-Western Pomerania, Saxony, Saxony-Anhalt, Saarland, and Thuringia and in parts of the federal states of Baden-Württemberg and North Rhine-Westphalia, only notaries who exercise their office full time are appointed as notaries (“Nurnotare”, or, “notaries only”) In the federal states of Berlin, Bremen, Hessen, Lower Saxony, Schleswig-Holstein and in parts of the federal states of Baden-Württemberg and North Rine-Westphalia, lawyers are appointed to practice the profession of notary in addition to the profession of attorney (“Anwaltsnotare”, or, “attorney/notaries”). In the state of Baden-Württemberg there are still District Notaries (“Bezirksnotare”). In deviation from the usual system, these notaries are civil servants of the federal state.

1.3 The Professional Education and Training of the Notary

An eligible candidate for the office of notary is anyone who has completed his or her education as an attorney at law and achieved full qualification as such (“Volljurist”). The notary initially goes through the same training procedure as a German judge or attorney, but must upon completion of the undergraduate curriculum, achieve further qualification through post-graduate studies. In order to ensure the retention of Germany’s extraordinarily high standard of notarial services, the appointment to the office of notary generally requires that the candidate have an outstanding academic record.

1.4 The Chief Professional Responsibilities of the Notary

1.4.1 Impartiality

The notary is not the legal representative of a single party, but rather the impartial counselor of all the parties involved in a given matter (Par. 14, Section 2 BNotO). Notaries, as opposed to attorneys, do not fight for the rights of their clients but rather stand above the interests of the parties by helping them to find a just way of balancing out their opposing objectives. In doing so, they cannot impose a binding decision with judicial authority, but can only influence the outcome of the legal process by advising and informing the parties. The impartiality required of notary means that they cannot take sides with or against any of the parties by showing preference or prejudice. No bond to one of the parties, no favoritism, no biases, no concern with their own personal advantages or disadvantages may influence notaries in the performance of their professional duties.

1.4.2 The Duty to Refuse Performance of Illegal and Unethical Transactions

Notaries must deny performance of any official functions that are not reconcilable with their official duties, particularly when their active support is requested in the pursuit of objectives that are obviously illegal or unethical (Par. 14, Section 2 BNotO). Furthermore, the German code of professional conduct (“Standesrecht”) prescribes that notaries avoid even the slightest appearance of infringement of the law.

1.4.3 Dignified Behavior

Through their behavior both on and off the job, notaries are required to demonstrate that they are worthy of the respect and confidence that the public places in their profession (Par. 14, Section 3, Sentence 1 BNotO). Notaries thus have the duty to do honor to their profession at all times and in all places, regardless of whether their

activities and behavior are job related or strictly private. For example, notaries are required to maintain order in their financial affairs. They may not live beyond their means, must pay their bills on time and are not permitted to demonstrate self-submission to boundless profit seeking by wagering in high-risk speculations. Furthermore, they are expected to display morally or conventionally conduct and respectable standards of living. Notaries are not even allowed to tolerate the involvement of a family member in unrespectable activity (Par. 14 III, Sentence 2 BNotO).

1.4.4 The Duty to Perform Professional Services

Notaries have the obligation of performing all the services associated with their office. They may not refuse their notarial services to anyone without valid reason. Legitimate reasons for refusal exist only when active involvement in forbidden activities is being solicited or when personal interests in the matter makes the legally proscribed impartiality next to impossible (Par. 3 of the German Notarial Recording Code [“Beurkundungsgesetz” (BeurkG)]).

1.4.5 Prohibition of Middleman Activities

Notaries are forbidden to engage in the brokering of loans and real-estate and to enter into obligations as loan guarantors or to offer any other form of security or any guarantee for one of the parties in conjunction with a transaction performed in the course of fulfilling their professional duties. Furthermore, they have the duty of making sure that none of the persons in their employ are involved in such commercial activity.

1.4.6 The Duties to Examine and Inform

Notaries have the obligation to examine the motives of the parties, clearly explain the facts of the matter to them, inform them of the legal ramifications of their desired transaction and, upon having done so, to protocol their statements clearly and unambiguously. During the course of this procedure, they must pay special care to ensure the avoidance of mistakes and doubts and make sure that inexperienced and/or unsophisticated parties are not disadvantaged. If they have any suspicions that the transaction goes against the law or the true motive(s) of one or more of the parties, they are obliged to share their suspicions with all present. However, if notaries have any doubt about the legal validity of the transaction, they cannot simply refuse to record it. In such a case they are obliged to inform the participants of the reasons for their doubts and to make note of those reasons as well as the statements the parties issued in response to them in the protocol.

Again, while informing and advising the parties, notaries must at the same time strictly adhere to their obligation of impartiality. They may not advise one party to its advantage while disadvantaging the other.

In informing the parties involved in a given transaction, notaries are obliged to adhere to the generally accepted rule that they must always choose the way that is most certain. Only if the parties insist on a divergent, less certain concept may a notary, after informing them of what that may entail, embark on their chosen uncertain path.

1.4.7 Selection of the Most Economical Alternative

If various alternative ways to conclude or perform a business transaction are available, the notary must select the alternative that is most economical. This fundamental principle is limited only by the principle discussed above that obliges notaries to take the most certain path.

1.4.8 No Financial or Tax Consulting

The law does not hold the notary responsible for providing information concerning the financial outcome of a business transaction. It is the sole responsibility of the parties to the contract to obtain such information for themselves by consulting advisory specialists (attorneys, tax consultants). The notary likewise has no obligation to inform the parties concerning the tax law consequences of a given contract.

However, in practice, it is hardly possible to adhere to these limiting principles. Notaries today are generally expected to provide financial advice and especially tax advice, particularly in questions concerning property-acquisition tax and inheritance tax. Should the notary lack sufficient knowledge in these areas, the parties should be so informed and be encouraged to involve specialists.

1.4.9 Obligation of Secrecy

Notaries have the obligation of strictly maintaining secrecy in all matters negotiated before them and in regard to the names of the parties involved. Any violation of the obligation of secrecy is threatened with penalty.

1.4.10 Obligation to Have Liability Insurance

Notaries are required to have professional liability insurance to cover any pecuniary losses resulting from the performance of their professional activities. The minimum policy amount is € 250,000 – for each insurance case. In practice, most notaries, because of the back-up policies offered by the notary associations, are insured for at least € 500,000.

2 Duties of the Notary

The main duty of notaries is the recording of legal transactions as well as the certification of signatures and copies. The most important areas of their professional activity will be explained below.

2.1 *Real-Estate Law*

Notaries are responsible for the recording of all types of real-estate transactions, especially those involving purchase contracts and real-estate gifts. If such transactions are carried out in non-notarial form, they are invalid. The purchase contract and the statements to the real-estate registry office necessary to carry out the contract are usually prepared by the notaries themselves. It is also possible that the parties to the contract present their notary with a ready-made document, which the notary then reads aloud and the parties sign in his presence. The notary can document such ready-made drafts only if their content is legally permissible and contains no disadvantage for one of the parties to the contract. Especially in the case of very complex real-estate transactions, it is common that the contracts have been drafted by the attorneys of the parties and already checked in terms of their legality.

In addition to documenting real-estate contracts, notaries are responsible for the official execution and registration of “limited property security rights,” especially liens, mortgages, rights of passage of the property by pedestrians and motor vehicles and similar property encumbrances. The notarized form is also a prerequisite to having the property registered in the real-estate registry, which is required for the transaction become lawful.

In summary, it can be said that all legal transactions according to the German real-estate law require a notarized form, and can be conducted in an effective and valid way only through the involvement of a notary.

2.2 *Company Law*

German law requires that all companies involved in commercial trade (“Handelsgesellschaften”) be registered in the commercial register (“Handelsregister”). The registration process requires the certified registration of the company shareholders (“Gesellschafter”) and the managing director(s) (“Geschäftsführer”), which can be done only through a notary. The duty to register and the duty to obtain notarized certification of the entry application also exists for any and all changes in the company, especially for increases or decreases in its nominal capital or for changes in the shareholder body and/or the company management.

The articles of incorporation (“Gesellschaftsvertrag”) themselves do not always require notarization. The articles of incorporation of a general partnership (“Offene

Handelsgesellschaft”[OHG]) or a limited partnership (“Kommanditgesellschaft” [KG]) are not subject to any specific form. Notarization in this case is possible but not absolutely necessary. On the other hand, the articles of incorporation of an investment company (“Kapitalgesellschaft”), a GmbH or AG require without exception notarization. The same applies to any changes in the articles of incorporation of an investment company, especially to measures for increasing and reducing the nominal capital value. In the case of the stock corporation (“Aktiengesellschaft” [AG]), every meeting of the stockholders must additionally be recorded by a notary.

The transfer of shares in a company must be notarized only in the case of the GmbH.

2.3 Inheritance Law

According to German law, a one-sided testament (will) can be effectively executed by the testator in his or her own handwriting. Notarization is a further possible means of executing a testament. For people unable to write, it is the only possibility. An advantage of the notarized testament is the advice provided by the notary, which ensures that the last testament of the testator is expressed in a way perfectly in keeping with the law.

In addition to the one-sided testament, German law provides for the possibility of drawing up an inheritance contract. Whereas the one-sided testament is freely revocable at any time, an inheritance contract is binding insofar as the testator did not reserve the right to revocation. The form of an inheritance contract is chosen whenever there is a desire to provide a security for an intended heir that the promised inheritance will not be revoked before going into effect. An inheritance contract always requires notarization.

Within the domain of inheritance law, notaries are additionally responsible for certifying a number of further statements that must be presented to the court of probate (“Nachlassgericht”). For instance, an application for issuance of an inheritance certificate must be certified by a notary. The same applies to a disclaimer of inheritance. Also requiring notarization are contracts for the renunciation of inheritance or of compulsory portions of an inheritance as well as any contracts made among the heirs-to-be. Inheritance purchase contracts and similar contracts that grant control of an estate in its entirety likewise require notarization.

2.4 Family Law

Family law comprises a further important area in which German notaries are active.

German matrimonial law provides, fundamentally, for a community of accrued gain among marriage partners (“Zugewinnngemeinschaft”). This community is a marital regime of the separation of property (“Gütertrennung”), which is intended to keep the

financial assets of both spouses separate. However, upon termination of the marriage through death or, particularly, through divorce, the financial gain accrued by both spouses during the duration of the marriage will be divided equally among them.

Any deviations from this basic regulation can be agreed to by the marriage partners in the form of a notarized matrimonial property agreement (“Ehevertrag”). First, an agreement defining the marital property regime as one based entirely on the separation of property can be entered into, which rules out the equal division of accrued gain upon termination of the marriage. On the other hand, it can also be agreed that the property brought into the marriage by each of the partners individually becomes common property (“Gütergemeinschaft”). Between these extreme poles of property separation and property pooling, there are many conceivable ways of modifying the statutory regulations governing the marital property regime and the way accrued gains are to be divided at the end of the marriage. For instance, it is possible to limit the amount that can be laid claim to as a share in the accrued gain to a fixed sum of money or to keep certain financial assets, especially shares in a business venture, out of the division of accrued gain entirely.

Furthermore, it is possible by way of a notarized matrimonial property agreement, to regulate alimony payments upon divorce and the way in which the accrued pension expectancies shall be divided. In particular, it is possible that one or both spouses waive the claim to post-matrimonial alimony payments or the division of pension benefits. It is also possible to limit the claims in terms of their amount or duration.

A matrimonial property agreement can be made before or during the course of a marriage (pre-nuptial or post-nuptial agreement). If the marriage has already broken down and is to be dissolved by divorce, a divorce settlement can be made before a notary that includes the items of regulation mentioned, as well as further agreements, particularly those pertaining to the division of mutual financial assets and household property and those concerning child custody and visitation rights. In this manner it is often possible to achieve considerable cost savings in a divorce suit since, if the matter has been comprehensively regulated by a notary in advance, only one attorney needs to be hired for the divorce proceedings, whereas without a notarized agreement, two attorneys are an absolute must.

2.5 Other Responsibilities of the Notary

The notary is also responsible for the following transactions:

- The preparation of affidavits that are to be presented to government authorities
- The keeping in safe custody or delivery of money, securities and other valuable
- Overseeing the drawing of lots
- Overseeing voluntary auction sales
- The issuance of powers of attorney to persons authorized to represent companies, in so far as this authorization derives from an entry in the commercial register or similar register

- The provision of professional services to the parties in all other undisputed proceedings, especially the preparation of documents and drafts and the advising of the parties together with their representatives in court and in their dealings with administrative governmental authorities

3 Validity of the Notarized Documents

Most of the cases in which the parties commission the services of a notary are cases in which the notarized form is required for the validity of the transaction.

The notarization of documents has yet further functions that make it advisable to choose this form, even when it is not proscribed by statute.

3.1 Probative Force of Notarized Documents

A notarized document presented in a civil process provides full probative evidence that the statements contained in it were made by the parties (Par. 415, Section 1 Code of Civil Procedure [“Zivilprozeßordnung” (ZPO)]). It is not necessary to convince the court of the correctness of the documents. The only objection that can be raised against notarized documents contain the inherent assumption of genuineness (Par. 437 ZPO). Only if the document displays superficial flaws such as erasures or a broken seal is its probative force disturbed. In that event, it is up to the court’s discretion to decide how great of an extent the probative value of the notarized document is influenced by the superficial flaws.

3.2 Notarized Document as Writ of Execution

A prerequisite to the procuring of a writ of execution or enforceable instrument is generally a non-appealable court decree according to German law. Such a decree often can be substituted through submission to immediate enforcement in a notarized document. In this case, the notarized document is itself the basis for the enforcement measure (Par. 794, Section 1, No. 5 ZPO). A purchaser of property, for example, can in this fashion subject himself in the real-estate purchase contract to an immediate enforcement of the claim against him in the amount of the purchase price, thereby enabling quick procurement of a court order in case of default. Instead, with an enforceable copy of the notarized document, which the notary provides without further examination, the seller can initiate enforcement

measures. The notarized document can in such cases spare the parties lengthy trial proceedings.

3.3 Enforceable Attorney Settlement

A further possible way of avoiding a time and cost intensive court trial is to have a notary declare a settlement agreement enforceable. In this case, the so-called “enforceable attorney settlement” (“vollstreckbarer Anwaltsvergleich”) can replace a court decree as the basis for enforcement measures.

4 The Fees of Notaries

4.1 Fee-Setting Principles

4.1.1 Identical Fees for All Notaries

The fees of notaries are regulated by statute (“Kostenordnung”[KostO]). The amount of the fee depends first of all on the object of transaction. A further determining factor is the value of the transaction. For all contracts, the notary receives a double fee; for one-sided statements, a simple fee. Powers of attorney and applications to the land registry (“Grundbuchamt”) and registry court (“Registergericht”) are calculated at half the regular fee. For enforcement and counseling services performed in the course of finalizing real-estate transactions notaries also receive one or more half fees, depending on the nature of the case at hand.

4.1.2 Prohibition of Fee Agreements

The fees charged by notaries are proscribed by statute and, thus cannot be subjected to individual agreement. In particular, notaries are forbidden to waive a portion of their fees in cases involving high transaction values. The measures are very much tighter here than they are in the area of attorney fees because notaries are not members of a free profession, but rather the holders of public office.

4.1.3 Degressive Scale

The notary fee scale is degressive, which is to say that the fee becomes progressively lower in proportion as the value of the transaction rises. The simple fee for

a transaction with a value of € 5,000– is € 42; for a transaction with a value of € 100,000 only € 207.

4.1.4 Minimum Fees and Maximum Fees

The minimum fee for a notary service is € 10. However, there are various maximum fees. For instance, the fee for the recording of the resolutions of shareholders can not exceed € 5,000 (Par. 47, Sentence 2 KostO). The maximum fee for the certification of signatures is € 130. In cases involving the recording of articles of incorporation and changes of corporate form, the maximum amount that can be assumed as representing the value of the transaction is five million Euro.

4.2 A Few Examples of Notary Fees

4.2.1 Real-Estate Contract

The recording of the purchase contract for a piece of real estate with a value of € 250,000 generates a notary fee in the amount of € 864. In addition to the recording fee, the notary receives several side fees, amounting in total to about 30% of the recording fee, for the enforcement of the transaction at the land registry, for the procurement of the required permits and, in the event that encumbrances have to be discharged for the procurement of the discharging documents. Further costs are added for printing expenditures at the rate of € 0.50 per page, postage costs and 16% value-added tax (VAD). Thus, the costs of a real-estate contract with a value of € 250,000 run somewhere in the range of € 1,500 and € 1,700.

4.2.2 The Formation of a GmbH

The formation of a limited liability company (GmbH) with a nominal capital value of € 25,000 – generates a fee of € 168, independent of whether the notary drafted the articles of incorporation himself or the shareholders and/or their attorneys did so themselves. There is an additional fee for registering the company and the name of the primary managing director in the commercial register, which, in the case of a company with a nominal capital value of € 25,000 amounts to € 84. The formation of a GmbH with the legally required minimum nominal capital value of € 25,000 generates notary fees in the range of about € 450 including printing and postage costs and VAT.

4.2.3 Testament (Will)/Inheritance Contract

The basis for determining the fee for a testament or an inheritance contract is the value of the testator's estate at the moment of recording, minus debts. A simple fee is charged for a testament, a double fee for an inheritance contract. A mutual testament of a wedded couple likewise generates a double fee. The costs of a testament in the case of an estate valued at € 500,000 would amount to € 807 plus out-of-pocket expenses for printing and postage, in addition to 16% VAT. The fee for an inheritance contract involving a net estate value of five million Euro would be € 15,114 plus 16% VAT.

Part VI
European Law

Institutions of the European Community

B. Tremml

1 Overview

The tasks entrusted to the European Community are carried out by five institutions: the Council, the Commission, the European Parliament, the Court of Justice and the Court of Auditors. The most important of these is the Council, in which the most significant governmental functions have been combined. The Council is primarily responsible for passing legislation and making the decisions necessary to realize the goals of the Treaty Establishing the European Community as amended (EC Treaty) and the Treaty establishing the European Atomic Energy Community. The Council consists of representatives of the governments from each Member State (currently 27). It is designed as a body whose function is to represent the national interests. Because all of the Council Ministers have a duty to follow the instructions of their governments, the Council's measurements have the effect of reconciling the differing interests of the Member States.

The Commission consists of 27 citizens of the Member States who are first nominated by the States and then, following a vote of approval by the European Parliament as a whole, appointed by common accord of the Member States. The Commission must include at least 1 citizen from each Member State but may not include more than two members from the same State.

In contrast to the Council, the functions of the Commission are primarily executive rather than legislative, although it does play an authoritative role in shaping Community policy and in the legislative process in general. For example, only the Commission is empowered to submit proposed legislation to the Council or the Parliament. The Commission is also in charge of the Community's extensive administrative apparatus and represents the European Community on an international level. If a Member State fails to comply with Community law, the Commission can file a complaint with the European Court of Justice and institute enforcement proceedings; thus acting as the "guardian of the Treaties".

Another important institution of the European Community is the European Parliament. The Parliament consists of currently 785 representatives of the Member States who are elected by direct universal suffrage. Depending on the type of legislative proposal being considered by the Council, the Parliament is empowered to

participate in the legislative process in basically one of two different ways, either by giving its assent (without which such assent a proposal cannot become law) or by giving an advisory opinion. An advisory opinion is not binding on the Council, but might force the Council to adopt the proposal by unanimity, only in case it does not follow the opinion of the Parliament. However, the Parliament cannot enact any law by its sole power against the will of the Council. It differs in this regard very much from the encompassing legislative powers of any national parliament. But the functions and powers of the European Parliament have been steadily enlarged over the last years and this tendency is supposed to go on in the future, thus lessening what is called the “democratic deficit” of the European Community.

The European Court of Justice, which is discussed in greater detail in “III” below, consists of 27 judges who possess the qualifications required for appointment to the highest judicial office in their respective countries. The Court ensures that European Community law is uniformly interpreted and effectively applied. It safeguards and maintains the rights and duties of the Member States, institutions, businesses and individual citizens and rules on questions involving the legality of Community law. A Court of First Instance has been attached to it since 1989.

The Court of Auditors consists of 27 members with proven auditing experience who are chosen from the population of the Member States. This institution is charged with the duty, among others, of examining the accounts of all revenues and expenditures of the Community.

The European Central Bank (ECB) in Frankfurt (Germany) is not an institution of the European Community according to the libel of the EC Treaty. It is an independent body with its own legal personality which may not be influenced by the institutions of the European Community or the governments of the Member States. This corresponds with the European Central Bank’s task to define and implement European monetary policy and its primary objective to maintain price stability within the Euro zone.

2 The Sources and the Legislation of the European Community

2.1 Sources of Community Law

The sources of the European Community Law are:

- The Treaties entered into by the Member State constitute the “primary law” of the Community. Their provisions have “direct applicability” in all Member States, which means that they are binding without any further act of transformation by any Member State into their national laws.

These Treaties often empower the Community institutions to enact laws in order to further the Treaties’ goals.

- The law enacted by the Community Institutions themselves is known as “secondary Community law” and usually takes the form of either a regulation or directive. But it also includes the treaties of international public law that the Community concludes, like the GATT or the WTO agreement for example.

A typical regulation or directive will be enacted by the Council upon the suggestion of the Commission and after either basically the

- The Council has obtained the opinion of the Parliament, which it is not bound to follow, but might in certain cases only be overruled by a unanimous vote of the Council; or
- The Council has obtained the approval of the Parliament, without which approval enactment is impossible (real veto-right of the Parliament).

It is important to note that law of the European Community prevails over all national law (“priority of the European Community law”). This does not mean that a national law which is incompatible with European Community law becomes automatically void (within the legal order of the Member State concerned), but that it is rendered inapplicable in case of a legal conflict with the pertinent European Community law.

Even though in Germany this prevailing character of the European Community law is somehow disputed as far as Fundamental Rights of the Constitution (“Grundrechte des Grundgesetzes”) are concerned, the highest Court of the Federal Republic of Germany (the Federal Constitutional Court [“Bundesverfassungsgericht”]) has over the years basically come to accept it under certain preconditions (judgements of Oct. 22, 1986 [“Solange II”] and Oct. 12, 1993 [“Maastricht”]).

2.2 Some Types of Laws within the European Community

2.2.1 European Community Regulations

A regulation is of abstract and general character and, therefore, comparable to the function and objectives of national laws. According to Article 249, paragraph 2 of the EC Treaty, the regulations of the Community are binding in their entirety and directly applicable in all Member States. As mentioned above in the context of the primary law of the Community, direct applicability means that the regulation takes effect automatically upon being published in the Official Journal of the European Community. No further legislative action on the part of Member States is required.

Community regulations have the effect of granting rights as well as imposing responsibilities on the governmental agencies, courts and natural or legal persons of the Member States. Any national law which conflicts with a regulation is rendered inapplicable, due to the priority of European Community law.

2.2.2 European Community Directives

As a general rule, directives are not directly applicable (compare Article 249 paragraphs 2 and 3 of the EC Treaty). Unlike regulations, they must be incorporated into the law of the Member States before they take effect. A Community directive gives the Member States the legislative goal to be achieved. The States then have the duty under Article 249, paragraph 3 of the EC Treaty to incorporate the directive's provisions into their national law. In so doing, the Member States cannot change the content of the directive. However, they are given the discretion to determine the form and method of incorporation. Directives serve to harmonize the effect of the laws of the Member States. On the other hand, regulations lead to uniformity and standardization of the laws throughout the Community.

The general principle that a directive cannot be directly applied until acted on by the Member State has been considerably modified by the European Court of Justice. In line with its decisions regarding the direct applicability of primary law, the Court has held that under certain specific circumstances, a directive is applicable without Member State action. According to the Court of Justice, the individual can seek direct application of a directive by the national courts, even if it is not yet a part of national law, if the requirements set forth in the Court's "Becker" decision are met (Court of Justice, Case 8/81, 1982 E.C.R. 53). The Court of Justice held in "Becker" that the provisions of a directive can be directly applied

- If the Member State has not in a timely or sufficient manner incorporated the directive into its national law, *and*
- If the particular provision in the directive in question is itself sufficiently exact and its content is unconditional.

Whether or not a directive has been incorporated into the Member State's national law in a timely fashion is usually easy to determine, because most directives contain a provision stating when this must be accomplished. It is more difficult to prove that this same incorporation has not been performed sufficiently. This requires detailed arguments which show exactly how the national government fails to comply with the standards set by the directive.

A provision in a directive is considered sufficiently clear or certain if it contains a precise legal proposition. In other words, the content of the provision and the category of persons or entities addressed by it must be determinable, at least through interpretation.

Finally, the content of a directive is unconditional if the obligations imposed by it can be applied and made effective without the necessity of the Member States or the institutions passing additional rules or taking any additional action.

A determination of whether or not a directive is directly applicable must be made on a case by case basis. The rationale given by the Court of Justice for allowing the direct application of directives under the above outlined circumstances is that a Member State should not be allowed to circumvent its duties with regard to directives by an untimely and/or improper incorporation of the directive into its national law. If the citizens of a Member State could be deprived of their individual

rights granted by the Community's directives just because of the Member State's dereliction of duty, the practical effectiveness of directives would be limited or even completely frustrated. Moreover, direct applicability of directives helps to safeguard the effectiveness of the Community.

From this rational follow two other important aspects of the direct applicability of directives: they may only be invoked by a private individual against the State (and not vice versa or against another private person), and the determination concerned may only be applied in favor of the individual, not to its detriment.

The effect of the Court of Justice's decision has been to carve out another way to sanction Member States who fail to timely and sufficiently incorporate directives into their own law, in addition to the Treaty Violation Proceeding of Article 226 of the EC Treaty (discussed below under Sect. 3.3).

The German Federal Constitutional Court has upheld the Court of Justice's decision allowing for the direct applicability of directives. The Federal Constitutional Court has found the Court of Justice's decision to be a legitimate, constitutionally acceptable development of the law of the European Community.

In case of a directive which has not been properly implemented by the Member State but which is not directly applicable due to the lack of its provisions being sufficiently exact and unconditional, the Court of Justice has recognized in the "Francovich" decision, that the individual may claim damages from the State concerned under certain preconditions (Court of Justice, Joined Cases C-6 and 9/90, 1991 E.C.R. I-5357).

3 The European Court of Justice

3.1 The Court of Justice and the Court of First Instance

The European Court of Justice is located in Luxembourg. As mentioned above, the Court of Justice is charged with ensuring that the law is observed in the interpretation and application of the EC Treaty as well as other primary and secondary law. The decision-making tribunal consisting of 27 judges is served and supported by eight Advocates General. These individuals neither represent a party to the proceeding nor are they members of the bench; rather, they serve as legal consultants to the Court. Their position is similar in certain respects to that of a judge insofar as the Advocates General are independent and impartial and responsible solely for the upholding of Community law. They present an advisory opinion to the judges on the relevant facts and the applicable law in each case pending before the Court. As a result, each case is examined by two independent bodies within the Court, thus contributing to an extensive and thorough analysis of all issues raised.

In 1988, in order to ease the burdened Court of Justice, a Court of First Instance was created whose judgments are subject to a right of appeal to the Court of Justice on points of law only. The Court of First Instance is not a new European Community institution; rather, it is a part of the Court of Justice. Both its administrative and

budgetary structure is attached to that of the Court of Justice. It is also located in Luxembourg. One important difference between the courts, however, is that the Court of First Instance is not served by the Advocates General.

3.2 *Jurisdiction*

The Court of Justice and the Court of First Instance have exclusive jurisdiction in various types of proceedings which are explicitly enumerated. Two of them will be discussed in greater detail below. There is no general clause defining the jurisdiction of the Court in an abstract way.

Currently, the jurisdiction between the Court of Justice and the Court of First Instance is divided as follows:

The Court of First Instance has jurisdiction over all actions brought by natural or legal persons against the European Community institutions. The Court of Justice has jurisdiction over all actions filed by a Member State or an European Community institution. Consequently, the latter do not benefit from a possible appeal on the European level. as a result of this division of jurisdiction between the two tribunals. The Court of Justice decides more on “constitutional” issues like the division of power between the Community Institutions themselves or the European Community an the Member States, whereas the Court of original jurisdiction is more likely to get involved in “administrative” matters. However, both bodies may take over the role of a “civil” court and render judgements on claims for damages or act as arbitrators.

However, the EC Treaty provides in Article 225 that the Council may transfer further classes of actions and proceedings to the Court of First instance, upon request of the Court of Justice and following consultation with the European Parliament and the Commission. The sole type of proceeding which with certainty will not be assigned in the future to the Court of First Instance is the Preliminary Ruling Proceeding under Article 234 of the EC Treaty, since this proceeding is explicitly excluded from a possible transferal.

Regarding the division of jurisdiction between the Court of Justice (including the Court of First Instance) and the national courts, as long as there is no enumerative, explicit or exclusive jurisdiction of the Court of Justice set forth in the EC Treaty, the national courts remain competent. It is important to emphasize that the Court of Justice has not been placed over the national courts and, therefore, is not empowered to reverse the judicial decisions of the national courts. This is particularly obvious in the Preliminary Ruling Proceeding under Article 234 of the EC Treaty (see Sect. 3.4 below).

3.3 *The Treaty Violation Proceeding*

The purpose of the Treaty Violation Proceeding is to stop the violation of Community law by a Member State. Either the Commission (Article 226 of the EC

Treaty) or another Member State (Article 227 of the EC Treaty) may initiate a Treaty Violation Proceeding, even when the Member State is not directly affected by the violation. However, the latter cases are rather rare compared to the very important, frequently initiated proceeding from the part of the Commission.

Individual citizens or legal persons are not entitled to file a Treaty Violation Proceeding with the Court of Justice.

3.3.1 Procedural Steps of the Treaty Violation Proceeding

If the Commission is convinced that a Member State has failed to fulfill any obligation under European Community law, the Commission shall so inform the Member State concerned. The State then has the opportunity to respond to the alleged breach and to end the possible violation at this early stage.

If the State concerned cannot sufficiently convince the Commission that it has not violated European Community law or that it has come into compliance, the Commission will issue a reasoned opinion regarding the violation and lay down a period for the State to comply with this opinion. If the State does not follow the reasoned opinion in time, the Commission may bring the matter before the Court of Justice.

3.3.2 Prerequisites of a Treaty Violation

In order to prevail in a Treaty Violation Proceeding, it must be proven that the underlying act which constitutes a violation of Community law can be ascribed or imputed to the Member State (the Court looks at the legal situation at the point in time when the specified time period given the Member State to respond to the reasoned opinion expires).

Treaty Violation

In a Treaty Violation Proceeding, it must be proven that the Member State has “failed to fulfill an obligation under this Treaty”. Despite the seemingly unequivocal wording of this EC Treaty provision, “an obligation under this Treaty” has been interpreted to refer not only to primary law such as the treaties, but also to secondary law such as regulations and directives, and to agreements of the Community with third party States as well as to the general legal principles of the Community as interpreted by the Court of Justice.

A Member State has “failed to fulfill” its Treaty obligations when it has either not applied Community law at all, incorrectly applied it, or has committed an act which constitutes an affirmative violation of a specific provision of Community law. For example, a frequently occurring Treaty violation consists of the Member States not implementing European Community directives in time.

The party who lodged the complaint (normally the Commission) has the burden of proof.

Violation Attributable to a Member State

From the perspective of Community law, a Member State is perceived as one uniform actor, which means that it is held responsible for all violations of Community law which are committed by subordinate institutions, agencies or bodies of the State which includes the national Parliament, members of the executive branch or its administrative offices and even courts. In countries with a federal system such as Germany, the Member State can also be held responsible when one of the legislative bodies of the states violates European Community law, for example, if it refuses to incorporate in a timely manner a Community directive into its own state-wide law. However, actions or the failure to act of private persons, which constitute a violation of Community law, cannot be ascribed to the Member States unless they exercise an essential influence on the behavior of the private person concerned.

The particular problem of this responsibility of a Member State for any failure from the part of public authorities in the widest sense within its territory is obvious, that is, how should the Member State end a violation due to an independent body, such as for example a Parliament or a court? Even if the Court of Justice declares that a treaty violation has occurred, neither the highest national court nor any other branch of the Member State's government has the authority to simply set aside the independent body's decision. In such a case, there exist only informal methods of using influence by consultation and advice, which method seems to have been successful to date.

Moreover, Treaty Violation Proceedings are rarely initiated against National courts, even if their decisions either do not respect the priority of the Community law or fail to apply it. This is because more efficient options exist that can bring the national courts into compliance with Community law. One of them is the procedure under Article 234 of the EC Treaty, which empowers national courts to seek a preliminary ruling by the Court of Justice (see Sect. 3.4 below). In this way, the court can ensure that a correct interpretation of Community law is applied to its case and avoid any possible violation of European Community law.

In addition, a party adversely affected by a national court's failure to uphold Community law can make use of methods under German law to challenge the decision. According to German Federal Constitutional Court decisions, a court which violates its duty under Article 234 EC Treaty to request a preliminary ruling, has simultaneously violated Art. 101 paragraph 1, sentence 2 of the German Constitution (which guarantees that no one may be removed from the jurisdiction of his lawful judge ["Recht auf den gesetzlichen Richter"]). On the basis of this violation of German Constitutional law, an aggrieved party is entitled to file a constitutional appeal of the national court's decision.

This check within German law for ensuring that Community law is followed has its limits. First, it requires that the party is harmed rather than advantaged by the national court's decision which violates Community law. Secondly, the violation must be due to an arbitrary behavior of the national court. Finally, it is not an available option when the national court has no duty to request a preliminary ruling (see Sect. 3.4.2 below).

3.3.3 The Decision of the Court of Justice and its Enforcement

If a Treaty violation is proven, the Court of Justice merely declares that a violation has occurred (declaratory judgment). Acts which violate the Treaty will neither be set aside nor held to be illegal, nor will the Court specify what actions must be taken in order for the Member State in violation to come into compliance. Rather, the Member State itself is required to determine the necessary compliance measures and to implement those measures. If the Commission subsequently determines that the Member State has not done this, it may, after giving the State an opportunity to respond, issue an opinion which specifies how the Member State has failed to comply with the judgment of the Court of Justice. If the Member State still fails to come into compliance within the time specified in the Commission's opinion, the Commission may once again bring the matter before the Court of Justice and seek an order imposing a lump-sum penalty on the Member State.

3.4 The Preliminary Ruling Proceeding

The Preliminary Ruling Proceeding under Article 234 of the EC Treaty also plays an important role in Community affairs. To date, approximately one-half of all Court of Justice proceedings have been of this type.

The Preliminary Ruling Proceeding is not a proceeding by way of action, but a proceeding "from court to court". Despite its name, this judicial proceeding does not involve an initial decision by the Court of Justice, followed by a decision of the national court. Rather, it is an interlocutory proceeding in the sense that the underlying case begins in the national court, and after an interlocutory hearing before the Court of Justice in which the national judge seeks an interpretation of Community law relevant to his or her decision, it ends in the national court. Applying the Court of Justice's ruling and the rendering of a final judgment in the case remain the province of the national court. This shows that the Preliminary Ruling Procedure does not set up any hierarchical relationship between the Court of Justice and the national courts, but rather institutionalizes a form of cooperation where the Court of Justice provides the national courts with helpful support.

One important purpose of this proceeding can be seen from the goals and mission of the Community as well as from the proceeding's effect, namely, the consistent development of Community law. To the extent that Community law is directly applicable in the Member States and, therefore, subject to the interpretation of their national courts, a danger of inconsistent application and interpretation exists. Such a danger runs afoul of the Community goal of integration. If the development of Community law were left solely to the national courts, they would tend to interpret the Treaties, regulations, directives, etc. of the Community in light of their own nation's legal tradition and methods.

The Preliminary Ruling Proceeding, therefore, provides a way of preventing the threatened inconsistent interpretations of Community law from nation to

nation and, instead, fosters its standardization and even application throughout the Community. It provides a mechanism whereby the Court of Justice can “flesh out” the meaning of the often generally stated principles of the Treaties. At the same time, the proceeding helps the judges of the various nations of the Community with the difficult tasks which may arise out of the co-existence of national and Community law.

3.4.1 The Prerequisites of the Preliminary Ruling Procedure

Only a “court or tribunal of a Member State” can initiate a Preliminary Ruling Proceeding. The parties of the underlying case (for example, citizens and/or legal persons who have a dispute with a government agency), the institutions of the Community, administrative agencies of the Member States as well as courts from countries who do not belong to the Community are not entitled to seek a Preliminary Ruling from the Court of Justice.

The term “court or tribunal of a Member State” means an independent tribunal which derives its judicial power to resolve disputes from the public. Such a tribunal is required to be of permanent character, founded on a legal basis, having obligatory jurisdiction and exercising its judicial powers in a contradictory procedure. For example, administrative agencies and officials which provide citizens an opportunity to be heard, but whose decision-makers lack the requisite independence are not considered to be a “court or tribunal of the Member State” in this sense. Also, courts of arbitration are not entitled to present a Preliminary Ruling question since they are not part of the public authority.

As subject matter of a Preliminary Ruling, the most important are:

- The interpretation of the Treaties, which means the whole primary European Community law; and
- The interpretation and validity of acts of the institutions of the Community and the European Central Bank, which means the whole secondary European Community law.

It is important to note that the Court of Justice is not empowered to rule on the *validity* of primary European Community law. Also, the Court does not decide on the applicability of European Community law in the national case underlying the Preliminary Ruling request or the interpretation of the national law. The Preliminary Ruling Proceeding is concerned solely with the interpretation and validity of *Community* law.

Consequently, in order for a national court to make a request for such a ruling, it must find that a provision of Community law applicable to its case is in need of interpretation or that there is a justifiable doubt about the legality of the Community law provision under application. The national court must also determine that a decision on its legal question is necessary to its judgment in the pending case.

3.4.2 Right and Duty of a National Court to Request a Preliminary Ruling

According to Article 234 of the EC Treaty, each court of a Member State is entitled to request a preliminary ruling. This right, which generally may be exercised on a voluntary basis by the court, becomes a duty in the exceptional case that a national court wants to set aside secondary European Community law and not apply it to the pending case, since the court regards the pertinent European Community law to be invalid. In this regard the Court of Justice claims to be the sole body which may dismiss secondary European Community law for reasons of invalidity (“Verwerfungsmonopol”). Even though this is not explicitly laid down in Article 234 of the EC Treaty, it follows clearly from the purpose of the Preliminary Ruling Procedure, to assure the uniform application of European Community law throughout the Community.

Under Article 234 of the EC Treaty, “a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law [...] shall bring the matter before the Court of Justice”. Mostly, this provision is understood to refer not only to the highest courts in the judicial hierarchy of each Member State, but to all courts whose decisions may not be appealed in any given concrete case. However, there are some exceptions where national courts of “final appeal” may not request a Preliminary Ruling:

- The question raised is not necessary for the final decision of the court; or
- The question raised has already been decided by the Court of Justice in an earlier request for a Preliminary Ruling and the national court does intend to follow the earlier decision; or
- There is no real doubt possible of how a particular provision of European Community law is to be interpreted (“acte clair”) and there is a common sense of this among the national courts of other Member States as well

Article 234 of the EC Treaty clearly includes also the German Federal Constitutional Court. However, there is a strong and lasting controversy regarding whether or not this highest court (what ruling or what) should be “submitted” to the Preliminary Ruling Proceeding before the Court of Justice. It is also improbable that the Federal Constitutional Court would request a Preliminary Ruling if it came to, for example, doubt the interpretation of a provision of European Community law. So far, Germany’s highest court has carefully managed to avoid an open confrontation with the Court of Justice on this matter by successfully cooperating with the latter.

3.4.3 The Decision of the Court of Justice

As mentioned above, in its judgement, the Court of Justice rules only on the question of Community law posed to it. It declares what the Community law relevant to the case is. In this regard, the Court reaches its decision without regard to the final decision in the underlying national case. It does take into consideration the concrete

facts of the underlying case which the national court initiating the request shall report to the Court of Justice. For example, the concrete structure of a legal entity under the national business law of a Member State can be such relevant factual background necessary for the Court of Justice to decide whether the national legal entity falls within the scope of freedom of establishment.

The Judgment of the Court of Justice is binding to the national court. It must apply the European Community law, as interpreted by the Court of Justice, without modification.

3.4.4 Effect of the Preliminary Ruling Proceeding for European Citizens

Despite the fact that only a court can initiate a Preliminary Ruling Proceeding, this proceeding still serves the important function of protecting the individual's rights under Community law. As a result of the legal decisions of the Court of Justice providing for direct applicability and priority of Community law, actions of citizens are often directly influenced by European Community law. They can assert these rights in national court proceedings. The national courts in turn have the right or sometimes the duty (see Sect. 3.4.2) to initiate a Preliminary Ruling Proceeding in order to clarify, if and to what extent a citizen may claim any rights under European Community law. In this way, the citizens' rights under Community are indirectly protected. For example, parties to a proceeding before a national court can defend themselves against actions of a Member State which violate Community law by requesting that the court submit the question of the compatibility of the Member State's action (or lack of action) with provisions of Community law to the Court of Justice. Also, the parties involved in the national case underlying the Preliminary Ruling Proceeding may take part in the proceedings before the Court of Justice.

However, citizens cannot force the national court to submit questions of interpretation of Community law to the Court of Justice. The citizen can only attempt to persuade the national court of the necessity of initiating a Preliminary Ruling Proceeding. If the national court believes that its case is not significantly impacted by Community law, it is not required to seek a preliminary ruling from the Court of Justice. However, if this constitutes a violation of the sometimes given duty of a court to request a preliminary ruling, the citizen still has the possibility to seek the constitutional relief described in Sect. 3.3.2.2 above.

The two proceedings before the Court of Justice examined above, the Preliminary Ruling Proceeding of Article 234 as well as the Treaty Violation Proceeding of Article 226, involve the submission to the Court of Justice, cases whose resolution has significance and meaning for the entire Community. Both proceedings give the Court the opportunity of interpreting Community law in the context of concrete situations. The development of Community law into a self-contained and unified system is fostered by the Court's gradual development of the law on a case by case basis.

Antitrust Law in the European Community

B. Tremml and M. Luber

1 Introduction to the Antitrust Law of the European Community

Normally, business enterprises do not have to deal with European but only with national public offices. When they encounter European law as directly applicable, it is in the form of regulations and, even then, it is not enforced by European public offices but by their national counterparts. An important exception to this rule is European antitrust law: here the business enterprise affected has to deal directly with the European Commission as a European public office and with European law. That is perceived most acutely whenever fines are imposed on companies for violations of antitrust regulations. Thus, there exists a legal order parallel to the body of national laws, and it is essential that investors familiarize themselves with it.

In addition to European antitrust law, national antitrust laws – as for example the German Act Prohibiting Restrictions of Competition – exist in most member states controlling unfair competitive practices within the member state's internal market. However, the European antitrust law takes precedence over national antitrust law. To the extent that an antitrust law suit has cross-border effects, only European antitrust law is applicable. Due to the fact that most contemporary business activities have an impact on more than one member state, national antitrust laws currently play a limited role. National law is applicable only when and if the fusion does not have any community-wide impact. Thus, even if the Commission does not perceive any impairment of inner-European competition or prohibit the merger for that reason, it can still be prevented by national law.

The antitrust provisions of the European Community Treaty, which generally encompass Articles 81–86, and the regulations adopted pursuant to the Treaty, represent significant restrictions on the freedom to do business. Nevertheless, they are necessary to foster fair competition and the integration of markets as well.

2 The Different Types of Prohibition

Restrictions of competition can result from concertation in legal transactions, actual impairments through abuse of a dominant market position or mergers. European law has devised a three-pillar concept for dealing with these three types of competition-stifling strategies: any attempts to stifle competition through legal transaction are prohibited by Article 81 EC, abuse of a dominant market position is forbidden by Article 82 EC and mergers are subject to the amalgamation controlling procedure laid out in the amalgamation controlling regulations.

2.1 Article 81

Article 81 prohibits any and all agreements and resolutions that are aimed at restricting competition or that result in such. The purpose of Article 81 is to establish a common market within the European Community by promoting free competition between enterprises of the private and public sector.

Article 81 of the EEC Treaty states:

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the Common Market, and in particular those which:
 - (a) Directly or indirectly fix purchase or selling prices or any other trading conditions
 - (b) Limit or control production, markets, technical development or investment;
 - (c) Share markets or sources of supply
 - (d) Apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage
 - (e) Make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts
2. Any agreements or decisions prohibited pursuant to this article shall be automatically void.
3. The provisions of paragraph one may be declared inapplicable in the case of
 - Any agreement or category of agreements between undertakings
 - Any decision or category of decision by associations of undertakings
 - Any concerted practice or category of concerted practices

which contribute to improving the production or distribution of goods or to promoting technical or economic progress while allowing consumers a fair share of the resulting benefit and which does not

- (a) Impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives
- (b) Afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question

The term “agreement” is generally to be understood as referring to a contract in terms of civil law. This term comprises “horizontal agreements” (agreements between competitors operating at the same level in the economic process) as well as “vertical agreements” (agreements between non-competing enterprises operating at different levels). However, the term “agreement” in the sense of Article 81 of the EEC Treaty is not limited to formal contracts but has to be interpreted in a broader sense. That means that the provisions of Article 81 are always applicable when modes of behavior exist which have economic relevance such as informal agreements, imposed agreements and agreements declared to be non-binding.

Decisions by associations of undertakings can be made by members of the association as well as by their representatives. According to the decisions of the European Court of Justice, associations of undertakings in the sense of Article 81 do not require a certain legal or organizational structure. By interpreting this term in a very broad sense, the Court aims at enhancing the effect of the antitrust provisions.

A concerted practice, as that term is used in Article 81, is even less formal than an agreement and difficult to differentiate from so-called “parallel behavior”. The European Court of Justice declared in “ICI vs. Commission” (Case 48/69):

“Although parallel behavior may not by itself be identified with a concerted practice, it may however amount to strong evidence of such a practice if it leads to conditions of competition which do not correspond to the normal condition of the market, having regard to the nature of the products, the size and number of the enterprises and the volume of the said market.”

The object of such behavior must be the prevention, restriction or falsification of competition. “Restriction of Competition” has not been defined abstractly or generally by the Court of Justice of the European Community. Every case must be analyzed individually under the criterion of what possibilities enterprises would have on the open market if the suspect agreement did not exist. The restrictive impact of the agreement or concerted practice on competition must be significant. The provisions of Article 81 (1) enumerate several examples of forbidden cartels, such as discount cartels, price cartels, condition-fixing cartels, market-information agencies, tied distribution systems, prohibition of cross deliveries and agreements which discriminate against third persons.

The relevant market is not necessarily the entire market, but only that portion of the Common Market which can be viewed as an independent business area in which competitive relationships can be affected or destroyed.

2.2 Article 82 EC

Article 82 EC restricts an enterprise from using its market-controlling position to inflate prices or to drive out competitive enterprises.

Whereas Article 81 EG prohibits concertation among various companies that restricts competition, Article 82 EG is mainly concerned with the one-sided practices of a single company or conglomerate.

Article 82 of the EC treaty states:

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.

Such abuse may, consist in:

- (a) Directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions
- (b) Limiting production, markets or technical development to the prejudice of the consumers
- (c) Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage
- (d) Making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts

An enterprise has a controlling market position if it is in a position to avoid participation in competition or to exclude competition on certain cross-border markets for comparable products. An enterprise in such a position characteristically has a special free range of activity that is not restricted or controlled by competition. A decisive criteria in determining the existence of such a position is the competitive situation in the market in question, or the structure of that market, which is determined by the number of competitors active there and the size of their market shares.

In addition, the dominant position must purposely being abused, whether it be for the purpose of exploitation or in order to restrict competition. Exploitation of a dominant market position is to be understood as demanding market results that would not have been achievable if competition were functioning properly. Restrictions of competition on the other hand are any measures undertaken to hinder the activities of the competitors still remaining in the market or prevent potential new competitors from entering it.

2.3 The Control of Mergers

Articles 81–86 of the EC Treaty do not directly address the question under which circumstances mergers are consistent with Community Law. However, Article 3 (1) (g) EC requires the establishment of “a system ensuring that competition in the internal market is not distorted”. In order to be able to put a preventive control over mergers into effect, the Council of the European Union enacted regulation 139/2004 of 20 January 2004, the Council Regulation (EC) on the Control of Concentrations between Undertakings (hereinafter: EC Merger Regulation), effective from 1 May 2004.

The main target of this regulation is to maintain effective competition in the free market.

According to Article 3 (1) and (4) of the EC Merger Regulation concentration is deemed to arise where a change of control on a lasting basis results from

- The merger of two or more previously independent undertakings or
- The acquisition, by one or more persons already controlling at least one undertaking or
- The acquisition by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect *control* of the whole or parts of one or more undertakings or
- The creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity

The decisive factor is the criterion of gaining *control of one or more undertakings* over another undertaking which is defined in Article 3 (2) of the EC Merger Regulation as the possibility of exercising *decisive influence* on an undertaking.

The merger regulation is applicable to all mergers of undertakings that exceed a certain size and have community-wide importance. That is defined in terms of specific threshold figures:

A merger has a Community dimension if the following turnover criteria are met:

- The combined aggregate worldwide turnover of all the undertakings concerned is more than € 5 billion
- And
- The aggregate Community-wide turnover of *each of at least two* of the undertakings concerned is more than € 250 million
- Or
- The combined aggregate worldwide turnover of all the undertakings concerned is more than € 2.5 billion
- And
- The aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than € 100 million
- And
- In each of at least three Member States, the combined aggregate turnover of all the undertakings concerned is more than € 100 million
- And
- In each of at least three of these Member States, the aggregate turnover of each of at least two of the undertakings concerned is more than € 25 million

Where *each* of the companies concerned achieves more than two-thirds of its *Community-wide* turnover (not its aggregate worldwide turnover!) within one and the same Member State, the Commission has no competence even if the thresholds indicated above are exceeded. This proviso is meant to ensure that mergers which have effects mainly within one Member State remain within the competence of the national competition authority.

If these threshold values are surpassed, the Commission has the right to investigate whether or not the merger will lead to the achievement or intensification of a dominant market position. To that end, the planned merger has to be reported to the Commission before it takes place. The Commission has to decide within 1 month if it approves the merger or needs to conduct an in-depth investigation. Should such an investigation follow, that second controlling phase has to be wrapped up within 4 months. The final decision can be an approval of the merger as planned, approval with certain restrictions or rejection of the petition.

3 Exemptions to European Antitrust Laws

3.1 Introduction

The practices prohibited by European antitrust law are broadly enough defined to encompass many forms of business relationships which are often desirable from an economic point of view. Such business relationships include patent agreements, licensing agreements, know-how agreements and exclusive distribution or purchase agreements. In order to deal with these types of special cases, the Commission is empowered under Article 81 (3) of the EC Treaty to exclude certain agreements from the restrictions of European antitrust law. The Commission exercises this power through the granting of exemptions on a case-by-case basis (individual exemptions), as well as through the adoption of regulations granting categorical exemptions known as regulations on block exemptions. Besides, the Commission is entitled to issue a negative clearance and a concept letter. Finally, there is a special regulation for minor cases that exclude certain agreements from the restrictions of Article 81 EC.

3.2 Block Exemptions

3.2.1 Overview

The Commission has issued several regulations under Article 81 (3), which define the criteria for determining certain categories of agreements that are exempt from the European antitrust law.

A first differentiation is to be made between vertical and horizontal block exemptions. The first concern agreements between two or more business undertakings that are engaged in different levels of manufacturing or sales activities, whereas the second concerns business undertakings that are active on the same manufacturing or sales level.

Vertical block exemptions include, above all, the Commission Regulation (EC) No. 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty

to categories of vertical agreements and concerted practices, which supplanted the Exclusive Dealership Regulation from 6-22-1983, the Exclusive Procurement Regulation from 6-22-1983 and the Franchise Regulation from 11-30-1988. Besides, there is a Commission Regulation (EC) No. 1400/2002 of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector and a regulation to categories in the area of new technology transfer (No. 772/2004, in effect since 4-27-2004).

The regulations impacting horizontal agreements include the Regulation of Specialization Agreements, No. 2658/2000, passed on 11-29-2000, the Regulation on research and development agreements, No. 2659/2000, passed on 11-29-2000, and the Commission Regulation (EC) No. 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements.

3.2.2 The Regulation to Categories of Vertical Agreements and Concerted Practices

This regulation encompasses all agreements concerning the buying and selling of goods or services made by undertakings that are not in competition with the other ones. The expansion of the block exemption to cover all types of vertical restrictions of competition marks a significant improvement of the legal situation for companies with vertical agreements. The former “white list,” which itemized the prerequisites for legal exemption from antitrust laws, has been done away with.

The basic idea behind the exemption is that vertical agreements generally result in improved efficiency and, therefore, have an advantageous effect on the market. The objective advantages resulting from manufacturing and sales improvement generally balance out any negative impacts the agreement might have on the competitive situation in the market. That only applies as long as the undertakings involved do not have unlimited market power. Consequently, the regulations grant exemption only when the market share of the undertakings does not surpass 30%.

Under certain circumstances, the so-called “black clauses,” an exemption is impossible from the start. Those include particularly price fixing, territorial or customer limitations and restrictions of the vending of spare parts.

The Commission has passed detailed guidelines explaining how the regulations are to be applied (Official Journal EG 2000C 291/1). The most important explanations can be found in Sect. 6, which contains case examples for the treatment of different types of vertical restrictions of competition, for example, brand binding, exclusive dealing, customer restricting, franchising and exclusive supplying.

3.3 Individual Exemptions

In addition to the block exemptions just described, Article 81 (3) also grants individual exemptions. According to Article 1 (2) of the Council Regulation (EC) No.

1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, Article 81 (3) is directly applicable since 05-01-2004. That means an enterprise can't apply any more for granting an individual exemption by the European Commission, but has to decide itself, if the prerequisites of article 81 (3) are fulfilled.

Article 81 (3) contains four conditions which must be met in order to receive an individual exemption. The applicant must show that the agreement, transaction or practice

- (1) Will improve the production of goods or promote technical or economic progress
- (2) Will result in the customers obtaining a fair share of the resulting benefit
- (3) Is free of unnecessary restraints, and
- (4) Does not eliminate competition

Individual exemption is automatically ruled out if only one of these criteria is not met.

3.4 Finding of Inapplicability

Because Article 81 (3) EG is directly applicable, there is no way any more for a negative clearance or certification by the Commission that a specific project or transaction contains no practice which violates European antitrust law. Only where the Community public interest relating to the application of Articles 81 and 82 of the Treaty so requires, the Commission may by decision find that Article 81 of the Treaty is not applicable to an agreement, a decision by an association of undertakings or a concerted practice, either because the conditions of Article 81(1) of the Treaty are not fulfilled, or because the conditions of Article 81(3) of the Treaty are satisfied, see Article 10 of the Council Regulation (EC) No. 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty. The Commission may act on its own initiative, not because of an application of a company.

3.5 Minor Cases

The European Commission has issued a new notice regulating minor cases, the Commission Notice on agreements of minor importance which do not appreciably restrict competition under article 81 (1) (de minimis), Official Journal 2001/C 368/07, 12-22-2001. This notice sets the standards, the market-share thresholds, for determining when agreements among undertakings do not result in an appreciable restriction of competition under Article 81 (1) of the Treaty and, therefore, do not give cause for antitrust proceedings. This notice replaces the previously valid notice that went into effect in 12-9-1997. The most significant difference to the former notice is the increase of the market-share threshold from 5 to 10% (competitor) and

from 10 to 15% (non-competitor) as well as the inclusion of parallel agreements with a cumulative effect on competition.

Agreements between undertakings which affect trade between member states do not appreciably restrict competition under Article 81(1):

- (a) If the aggregate market share held by the parties to the agreement does not exceed 10% on any of the relevant markets affected by the agreement, where the agreement is made between undertakings which are actual or potential competitors on any of these markets (agreements between competitors)
- (b) If the market share held by each of the parties to the agreement does not exceed 15% on any of the relevant markets affected by the agreement, where the agreement is made between undertakings which are not actual or potential competitors on any of these markets (agreements between non-competitors)

Furthermore, the Commission assumes that agreements between small and medium-sized undertakings are rarely equipped to appreciably impact trading among the member states. Small and medium-sized undertakings are currently defined as undertakings which have fewer than 250 employees and have either an annual turnover not exceeding € 40 million (rise to 50 million intended) or an annual balance-sheet total not exceeding € 27 million (rise to 43 million intended).

4 Sanctions and Judicial Review

According to Article 81 (2) of the EC Treaty, agreements which do not comply with the EC antitrust law are void, and the EC Commission may impose severe penalties according to the Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No. 1/2003 (Official Journal C 210, 1.09.2006). The final amount of the fine shall not exceed 10% of the total turnover in the preceding business year of the undertaking or association of undertakings participating in the infringement, Article 23(2) of Regulation No. 1/2003. Where an infringement by an association of undertakings relates to the activities of its members, the fine shall not exceed 10% of the sum of the total turnover of each member active on the market affected by that infringement.

Decisions of the Commission and EC regulations can be challenged by the affected enterprises or persons. Suits must be filed in the EC Court of First Instance and instituted within 2 months of the notification of a decision to a party (in the case of an individual decision) or within 2 months of the publication of a new regulation.

All appeals based on errors of law alleged to have been made by the European Court of First Instance must be filed with the European Court of Justice. The European Court of Justice does not review factual matters.

If bodies of the EC cause damage to an enterprise or person by illegal acts, compensation from the European Community is also possible. Such claims must be filed in the European Court of First Instance, and in the event the claim is denied, appeal to the European Court of Justice is possible.

Part VII
Tax Law

German Tax Law

I. Badura

1 General Remarks

The German tax system is highly complicated and in constant flux. The following chapters should give a general idea to the investor of how taxation works in Germany. In any case, professional help should be used when starting business operations in Germany.

The German Business Tax Reform 2008 will in principle take effect on January 1, 2008. Most new rules will be applied for calendar year taxpayers from January 1, 2008 onwards. In the case of deviating fiscal years, the effective date may well be prior to that as new rules are often already applicable for the 2007/2008 fiscal year.

Further pending tax-relevant legislation is the governmental bill for the Annual Tax Act 2008. This bill was introduced into the German parliament for deliberation on August 8, 2007, and is expected to be passed later in 2007.

Changes are also expected in inheritance tax, such as further tax allowances for inheritances containing business entities, further tax allowances for close family members (children, grandchildren) and spouses, but higher taxation of private estates in general. Key points of the new inheritance tax were announced by the government on November 7, 2007. The inheritance tax bill is expected to be passed in spring 2008.

The influence of EU Directives and rulings of the European Court of Justice is constantly growing. There are a number of pending EU rulings, which will have a direct and heavy impact on German taxation (e.g., use of losses of affiliated companies within Europe).

2 Taxation of Corporations

2.1 *Basic Principles*

Any corporate entity domiciled in Germany is subject to taxation on its worldwide income (unlimited taxation). Corporations are subject to the corporate income tax, the solidarity surcharge, and the trade tax.

A corporate entity with no company seat or place of management and control in Germany has limited liability for German taxes on its German source income (limited taxation).

2.2 Corporate Income Tax (*Körperschaftsteuer*)

2.2.1 Determination of Taxable Income

Commercial annual accounts are the basis for taxable income. The taxable income is then adjusted under the Income Tax Act (*Einkommensteuergesetz*), unless special rules under the provisions of the Corporate Income Tax Act (*Körperschaftsteuergesetz*) apply. It is also important to note that all income derived by a corporation is deemed to be trading income.

Capital gains from the sale of shares in German or foreign corporations are free of corporate tax.

Examples of non-deductible expenses are the following:

- Corporate income tax
- Trade tax (until the end of 2007 a deductible expense)
- Expenses relating to tax-exempt income
- Expenses for hunting rights, yachts or guesthouses not located on business premises,
- 50% of remuneration paid to members of the supervisory board
- Business gifts per year per recipient exceeding € 35
- 30% of entertainment expenses (e.g., meals in restaurants)

2.2.2 Tax Rate, Solidarity Surcharge

Since 2001, the corporate income tax rate has been a uniform rate of 25%. From 2008 onwards, the new corporate income tax rate will be 15%. In 1991, a solidarity surcharge was introduced to support the economic development of the reunified German States. This surcharge of 5.5% is levied on corporate income tax, thus raising the tax burden for corporations from 15 to 15.825%.

2.2.3 Distribution of Profits Until the End of 2008

The so-called “Half-income” rule (*Halbeinkünfteverfahren*) provides that when individual profits are distributed, only 50% of that amount is subject to personal income tax.

If profits are distributed to another corporation, these profits are tax-exempt. In addition, the receiving corporation must treat an amount of 5% of the dividend as non-deductible business expenses.

If the entity is a partnership, dividends are only taxed at the level of the partners and not at the level of the partnership.

The distributing corporation has to deduct 20% of withholding taxes and remit that amount to the tax authorities. These withholding taxes can be offset against the final tax liability of the shareholders.

• Corporate income tax	25%	-20.8	-20.8
• Solidarity surcharge on taxes	5.5%	-1.1	-1.1
= Income after tax = <i>Dividend 2008</i>		61.4	61.4
• Withholding taxes	20%	-12.3	-12.3
• Solidarity surcharge on taxes	5.5%	-0.7	-0.7
= Dividend in cash		48.4	48.4
Taxable income of shareholder (50%/15% of dividend)		30.7	3.1
• Income tax (e.g., 40%)	40%	-12.3	-
• Corporate income tax	25%	-	-0.8
• Solidarity surcharge on taxes	5.5%	-0.7	0.0
+ Tax credit (withholding taxes)		12.9	12.9
= Income after taxes		48.4	60.5

2.2.4 Distribution of Profits from 2009 Onwards

The “Half-income” rule (*Halbeinkünfteverfahren*) will be changed to a flat tax for income from capital and capital gains earned by individuals holding the shares as private assets. Income tax on income from capital is fixed at a flat rate of 25% regardless of an individual’s personal income tax rate. Should the personal income tax rate be lower, this income can instead be taxed at this lower rate. The solidarity surcharge of 5.5% is applied on the flat tax rate as well as church tax in the case of membership in a state-approved church.

If profits are distributed to another corporation, these profits are tax-exempt. In addition, the receiving corporation must treat an amount of 5% of the dividend as non-deductible business expenses.

If the entity is a partnership, dividends are only taxed at the level of the partners and not at the level of the partnership.

The distributing corporation has to deduct 25% of withholding taxes and remit that amount to the tax authorities. These withholding taxes can be offset against the final tax liability of the shareholders.

Example: Distribution of profits from 2009 onwards		
Type of shareholder	Individual	Corporation
Income of corporation 2008	100.0	100.0
• Trade tax 3.5% × multiplier 400	-14.0	-14.0
• Corporate income tax	15%	-15.0
• Solidarity surcharge on taxes	5.5%	-0.8

(continued)

Type of shareholder		Individual	Corporation
= Income after tax = <i>Dividend 2009</i>		70.2	70.2
• Withholding taxes	25%	-17.5	-17.5
• Solidarity surcharge on taxes	5.5%	-1.0	-1.0
= Dividend in cash		51.7	51.7
Taxable income of shareholder (100%/5% of dividend)		70.2	3.5
• Flat income tax rate	25%	-17.5	-
• Corporate income tax	15%	-	-0.5
• Solidarity surcharge on taxes	5.5%	-1.0	0.0
+ Tax credit (withholding taxes)		18.5	18.5
= Income after taxes		51.7	69.6

2.2.5 Hidden Profit Distribution (*Verdeckte Gewinnausschüttung*)

All transactions between the corporation, its shareholders and other affiliated persons must be dealt with at “arm’s-length”. As a general rule, expenses considered to be disadvantageous to the corporation for the benefit of the shareholder will be reclassified as constructive dividends. If a corporation has effected a constructive dividend in a fiscal year, its taxable income for that year will be increased accordingly.

2.2.6 Interest Deduction Limitation (Thin Capitalization Rules)

Since 2004, thin capitalization rules have been applicable to companies with foreign shareholders and companies with shareholders which are subject to unlimited German taxation.

Until the end of 2007, a remuneration exceeding € 250,000 paid by a corporation to its shareholders is a hidden distribution of profits (constructive dividend) if

- The remuneration is not calculated at a fixed rate of interest *or*
- The debt-equity ratio at any time of the fiscal year exceeds 1.5:1 (safe haven).

Starting with the fiscal year 2008, thin capitalization rules will change completely. Effective from January 1, 2008, a corporation will only be able to deduct net interest expenses up to 30% of EBITDA (interest deduction ceiling). EBITDA is defined as pre-interest, pre-loss carry-forward profits for tax purposes, increased by the tax depreciation and amortization incurred. Interest expenses in excess of the ceiling may be carried forward.

The interest deduction ceiling will not apply where one of the following exceptions is met:

- Net interest expense is less than € 1 million
- The corporation is not part of a consolidated group (group according to IFRS rules)

- The escape clause applies: the corporation proves that the equity ratio of the German business entity does not deviate by more than 1% point from the worldwide group's equity ratio

2.2.7 Use of Losses

Tax losses may be carried back one year to offset profits up to € 511,500. Remaining profits may be carried forward without a limit on time.

Since 2004, a loss carried forward may offset an amount of up to € 1,000,000. Anything in excess thereof may offset no more than 60% of the taxable income of the current year.

Until the end of 2007, the offset of losses against future profits is conditioned on the corporation maintaining its legal and economic identity. Generally, the economic identity of a corporation is lost if more than 50% of its shares are transferred to a new shareholder *and* the company continues or reassumes its business with predominantly new assets. The introduction of new assets is not detrimental to the utilization of losses provided that the assets are used for restructuring that part of business that caused the losses. In the following 5 years the loss-making business should be continued.

Under the revised rule of the Business Tax Reform 2008, a direct or indirect ownership change of more than 25% to one shareholder within a 5-year period will result in a partial forfeiture of all tax loss carry forwards. In the case of a purchase of more than 50% in a 5-year period, the entire loss would get lost. Special rules will apply if a group of persons together acquires a share of less than 25% each.

2.2.8 Group Taxation (*Organschaft*)

Consolidated tax returns are allowed under certain circumstances. For example, the shareholder (corporation, individual or partnership) might attribute profits and losses of controlled subsidiaries (*Organgesellschaft*) to its taxable income if a profit and loss pooling agreement (*Ergebnisabführungsvertrag*) exists and the subsidiary corporation is financially integrated with the controlling company. Such a pooling agreement must be effective for at least 5 years.

Another condition for group taxation is that financial integration exists from the beginning of the fiscal year of the subsidiary. Financial integration can be achieved through direct or indirect holding of more than 50% of the voting rights.

As a result, losses of the subsidiary may be offset against profits of the controlling company and contrariwise. Losses incurred by the subsidiary in prior years would not be included for tax purposes. They can only be used by the subsidiary after the tax group ends.

2.3 Trade Tax (*Gewerbesteuer*) According to the Business Tax Reform 2008

Under the German Business Tax Reform, the calculation of trade tax has been changed. Additionally, the rules for computing taxable income for trade tax purposes will be different effective for calendar year taxpayers from January 1, 2008 and deviating fiscal year from 2007/2008 onwards.

2.3.1 Basic Principles

Local municipalities levy trade tax. It is based on the corporation's "trade income". This trade income is multiplied by a fixed tax rate of 3.5%, resulting in a base value (*Steuermessbetrag*) for trade tax purposes.

A multiplier (*Hebesatz*), fixed by each local municipality, is then applied to the base value. This multiplier usually varies between 350 and 490%; the outcome of this is a tax charge of 12.25–17.15%. Municipalities are obliged to use a minimum multiplier of 200%.

Please note that trade tax is no longer a deductible expense, so the above-mentioned tax rates correspond to the effective tax rates.

2.3.2 Determination of Taxable Income for Trade Tax

Trade tax is levied on the basis of a corporation's income modified by certain adjustments. These adjustments are either additions or deductions. The most significant adjustment is the addition of 25% of all interest expenses and part of rental expenses.

To the extent that the following expenses were deducted, 25% of all interest payments, as well as 5% of lease payments for movable assets, 16.25% of lease payments made for the use of immovable property and 6.25% of royalty payments are to be added back into income. The add-back of interest expenses and rental expenses will only occur where the total amount of these financing expenses exceeds a minimum threshold of € 100,000.

To avoid double taxation in the case of affiliated companies, the trade income is reduced by the profits of these affiliated companies. In case of corporations, a minimum shareholding of 15% is required.

2.3.3 Group Taxation (*Organschaft*)

The rules that allow consolidated tax returns are the same as for corporate tax purposes.

2.4 Example for Computation of Corporate Income Tax and Trade Tax

The impact of trade tax after the German Tax Reform 2008 can be shown by the following example:

Example: Computation of taxes with various multipliers					
Multiplier	200	350	400	450	490
Trade tax:			14.00%		
3.5% × multiplier	7.00%	12.25%		15.75%	17.15%
Income before taxes 2008	100.0	100.0	100.0	100.0	100.0
• Trade tax	-7.0	-12.3	-14.0	-15.8	-17.2
• Corporate income tax 15%	-15.0	-15.0	-15.0	-15.0	-15.0
• Solidarity surcharge 5.5%	-0.8	-0.8	-0.8	-0.8	-0.8
= Income after taxes	77.2	71.9	70.2	68.4	67.0
Combined tax rate	22.8%	28.1%	29.8%	31.6%	33.0%

At the end of 2007, only the city of Munich uses the highest multiplier of 490%. All other major cities (more than 250,000 inhabitants) in Germany have at least a multiplier of 410. Only smaller municipalities compete with favorable multipliers of 300–400. The small municipality of Norderfriedrichskoog (55 inhabitants, but more than 450 companies residing there) in fact has a multiplier of 200.

3 Taxation of Partnerships

3.1 Taxation on the Level of the Partnership

Trade tax is levied on the level of partnerships. The basis for calculating trade tax is the business income according to the Income Tax Act. It then is adjusted for trade tax purposes. Calculating trade tax in a partnership context is done in a similar manner as in the case of corporations. In addition, there is a tax-free allowance of € 24,500 in the case of business carried out by a partnership or by an individual.

The taxable income attributable to the partners for corporate or income tax purposes is only calculated on the partnership’s income. The partnership itself pays no income tax or corporate income tax. Any compensation received by the partners for the supply of goods, the partnership’s own manpower, or loans to the partnership will be added to that partner’s share of taxable income.

3.2 *Taxation of the Partners*

Depending on whether the partner is a corporation or an individual, the assigned taxable income for that partner is subject to either corporate income tax or income tax.

Trade tax paid on the level of the partnership can partially be offset against personal income tax. Depending on the municipal rate of trade tax and the personal tax situation, the offset can be as much as the partner's share of trade tax, or less.

Trade income of the parent company (corporation or other partnership) will be reduced by the trade income of the affiliated company to avoid double taxation.

Starting with 2008, retained profits will be taxed upon application of the lower corporate income tax rate of 15% instead of the individual income tax rate of the partner. If these profits are later distributed, this income will be taxed with a flat rate of 25% plus solidarity surcharge of 5.5% on the flat rate.

3.3 *Thin Capitalization Rules and Group Taxation*

The new thin capitalization rules for corporations also apply to partnerships. As in the corporate context, partnerships can be a taxing entity for their subsidiaries.

4 Taxation of Branches of Foreign Companies

Non-resident companies with a branch in Germany are generally subject to limited tax liability in Germany. Taxable income is subject to either corporate tax or income tax on income derived by the branch.

If the foreign investor is a corporation, it is subject to the corporate income tax (15%) and solidarity surcharge (5.5% thereupon), resulting in a combined rate of 15.825%, which is then applied to the assigned profits of the branch. A trade tax is imposed as well.

If the foreign investor is an individual, the assigned profits of the branch are subject to the income tax.

5 Taxation of Individuals

5.1 *Basic Principles*

Individuals residing in Germany are subject to an income tax on their worldwide income (unlimited tax liability).

Non-residents are only subject to taxation on certain categories of income from German sources (limited tax liability).

An individual's income is subject to an income tax (*Einkommensteuer*), a solidarity surcharge (*Solidaritätszuschlag*), and the church tax (*Kirchensteuer*) if the taxpayer belongs to one of the official churches. In addition, the trade tax (*Gewerbesteuer*) is levied on income derived from trade or business.

5.2 Taxable Income

German income tax law differentiates between seven categories of income:

- Income from agriculture and forestry
- Income from a trade or business
- Income from self-employment
- Income from dependent personal services (employment income)
- Income from capital investments (i.e., dividends, interest)
- Rental income from real property and certain other tangible property as well as royalties
- Certain miscellaneous items of income (i.e., short-term capital gains, annuities and other periodic or recurrent income)

Taxable income is gross income less all deductions and allowances such as personal allowances, income-related expense deductions, special expense deductions and extraordinary allowances.

5.3 Filing Requirements

For income tax purposes, the tax year is the calendar year. Taxpayers who derive income from agriculture or forestry may have different fiscal years.

An individual who receives no income from employment must file a return if his income from all other sources (i.e., income from capital investments) during that year exceeds.

€ 7,664 (€ 15,328 in case of married couples filing a joint return). Regarding income from employment, there is often no requirement for filing since the deduction of wage tax at the source will already have guaranteed that the income has been subject to taxation.

Income tax returns must be filed no later than May 31 for the preceding calendar year. However, if a professional tax advisor (*Steuerberater*) prepared the tax return, a filing extension is granted until December 31. Further extensions may be possible for individual cases.

Filing of the income tax return does not require payment of the taxes due. Taxes due are payable within 1 month after receipt of the assessment note.

The taxpayer must make quarterly pre-payments for income tax purposes on March 10, June 10, September 10 and December 10. The local tax office assesses the payments with respect to the prior year's tax, unless substantial increases or reductions of the taxable income are anticipated.

A taxpayer who starts a business or self-employment is under the obligation to inform the local tax office of such a change within 1 month. The tax office will request the taxpayer to fill out a form, which, among other things, asks for the estimated profits in order to permit the tax office to fix pre-payments of tax.

5.4 Tax Rates, Solidarity Surcharge, Church Tax

Income tax is imposed at progressive tax rates:

Tax-free allowance singles	€ 7,664
Tax-free allowance married couples	€ 15,329
Marginal tax rates vary from	15–42%
Special marginal tax rate (starting in 2007)	45%
Flat tax rate for capital income (interest, dividends, capital gains, starting in 2009)	25%
Marginal tax rate of 42% starts	
• For singles with a taxable income of	€ 52,152
• For married couples with a taxable income of	€ 104,304
Special marginal tax rate of 45% starts	
• For singles with a taxable income of	€ 250,001
• For married couples with a taxable income of	€ 500,001

Examples for income tax:

Singles		Married couples (joint return)	
Taxable income in €	Income tax	Taxable income in €	Income tax
7,000	0	15,000	0
10,000	398	30,000	3,084
20,000	2,850	50,000	8,542
50,000	13,096	75,000	16,652
75,000	23,586	100,000	26,192
100,000	34,086	150,000	47,172
150,000	55,086	200,000	68,172

In addition to income tax itself, a solidarity surcharge (*Solidaritätszuschlag*) of 5.5% is levied on the income tax amount assessed.

Church tax is imposed by “official” churches in Germany, i.e., the Roman Catholic Church, the German Protestant-Lutheran Church, the Reformed Church,

and Jewish parishes. The church tax rate is 8 or 9% (depending on the German state of residency). Church tax is levied as a supplement to the assessed amount of income or wage tax.

Church tax only affects taxpayers who have unlimited income tax liability. Conversely, solidarity surcharge is payable by every taxpayer.

Individuals subject to limited tax liability will generally be taxed at the rate of single taxpayers on their German-source income only. However, a minimum tax rate of at least 25% applies. For EEC member state citizens this taxation rule may be disputable.

6 Value Added Tax (VAT, *Umsatzsteuer*)

6.1 Basic Principles

Individuals and entities who are engaged independently in a trade, business or profession for profit, are liable for value added tax. In the following discussion, the term “entrepreneur” will be used for the VAT-liable taxpayer. Value added tax liability arises regardless of domicile, nationality, seat of management or the place where an invoice is issued or payment is made.

The German value added tax system attempts to tax the final consumer only. Therefore, taxable transactions between entrepreneurs should not result in a tax burden for the involved parties. The entrepreneur who sells goods or services to another entrepreneur has to charge separately, on his invoice, the net sales price and the applicable VAT charge. The entrepreneur who purchases the goods or services may use such value added tax (*Vorsteuer*) charged to him as a credit against his own VAT payable on his outgoing invoices. By this procedure, the tax ultimately debits the final consumer.

Special VAT rules apply to entrepreneurs involved in forestry and agriculture.

6.2 Taxable Transactions

VAT is charged on the supply of goods and services within Germany. The private use of goods serving the enterprise (e.g., private use of a business car) also constitutes a taxable transaction.

The sale of a total business as a going concern is generally considered VAT-exempt. However, certain conditions have to be met.

6.3 Import Turnover Tax (*Einfuhrumsatzsteuer*)

The importation of goods from territories outside the EU (e.g., the U.S.) into Germany is subject to import turnover tax, which can be considered a special form of VAT.

6.4 VAT Rates

The regular tax rate amounts to 19% (up to the end of 2006: 16%). This is the standard rate for supplies of goods or services rendered within Germany.

Certain goods and services are subject to a preferential rate of 7%. The most important categories that receive this preferential rate are the following:

- Certain foodstuffs (e.g., meat, milk, coffee beans, tea, vegetables, fruit, sugar, flour, no alcoholic drinks, no food prepared in a restaurant)
- Agricultural products
- Print goods (e.g., books, newspapers, magazines, but no electronic books)
- Certain works of art (e.g., paintings)
- Services of theatres, orchestras, chorus, museums and similar entities
- Licensing subject to German Copyright Act (Urheberrechtsgesetz)
- Services rendered by non-profit organizations

Certain goods and services are exempt from VAT. The most common exemptions are:

- Exportation of goods to a non-EU destination and related services
- Intra-EU deliveries of goods and related services
- Medical, educational and charitable services
- Financial services (e.g., services of banks and insurance companies)
- Income from rent and lease, services related to real estate
- Sale of real estate

VAT on expenditures relating to the exportation of goods and intra-EU deliveries can be claimed back, regardless of the fact that the export or delivery itself is treated as VAT tax-exempt. For some services that have to do with real estate transactions and financial services, it is possible to opt to charge VAT in order to reclaim VAT on expenses in connection with these services and transactions.

6.5 Filing and Payment of VAT

Monthly advance returns on VAT are normally submitted. If the amount of the previous year's VAT was less than € 6,136, the return can be submitted on a quarterly basis. If the amount was less than € 512, no monthly or quarterly return is required. The monthly and quarterly returns have to be submitted no later than the tenth of the following month. The authorities can grant an extension of 1 month with payment of a security deposit. Payment of VAT is due at the same time as the submission of the return.

An annual tax return has to be submitted regardless. The usual deadline is May 31 of the following year.

6.6 Foreign Entrepreneurs

As a general rule, foreign entrepreneurs who do not dispose of a permanent establishment in Germany and who do not supply goods or perform services in Germany can apply for a refund of incurred German VAT. When asking for reimbursement of German VAT, foreign entrepreneurs must submit the original invoices to the “Bundesamt für Finanzen” in Bonn. The application for refund of German VAT has to be handed in no later than June 30 for VAT of the prior year. This deadline can not be extended! Further information can be taken from the internet page of the Bundesamt: <http://www.bff-online.de>

7 Inheritance and Gift Tax (*Erbschaft- und Schenkungsteuer*)

7.1 Basic Principles

Contrary to its name “Erbschaftsteuer”, the Inheritance Tax Act not only deals with transfers by reason of death but gifts as well. Gifts and transfers by reason of death are treated more or less the same under the German Inheritance Tax Act.

Inheritance tax is levied on transfers of property upon death if either the deceased was a German resident at the time of death or the beneficiary is a current German resident. If neither the deceased nor the beneficiary was a German resident at the time of death, then inheritance tax is imposed only on certain property located in Germany (limited tax liability).

Gift tax is imposed on transfers of assets during the donor’s lifetime, if either the donor or the recipient is a German tax resident. A donation of certain property located in Germany by a non-resident to a non-resident recipient is also liable to tax (limited tax liability).

Inheritance tax is not imposed on the estate as such but upon the beneficial share of each individual recipient.

7.2 Computation of Inheritance Tax

Inheritance tax is assessed on the basis of the taxable value of the property transferred according to the rules of the German Valuation Act (*Bewertungsgesetz*). Pursuant to the revised rules of the planned new inheritance tax in future valuation will be based on the market price.

Inheritance and gift tax classes

Class	Relationship	Tax allowance current law (in €)	Tax allowance in planning (in €)
I	Spouse	307,000	500,000
	Children and stepchildren	205,000	400,000
	Children of deceased children and stepchildren	205,000	400,000
	Grandchildren	51,200	200,000
	Parents and grandparents (for inheritances)	51,200	100,000
II	Parents and grandparents (for gifts)	10,300	20,000
	Brothers, sisters, nephews, nieces, stepparents, parents-in-law, sons-in-law, daughters-in-law, divorced spouses	10,300	20,000
III	All others	5,200	20,000
	Limited tax liability	1,100	1,100

In the cases of transfers at death, there are special maintenance allowances for the surviving spouse and children under 27. The surviving spouse may receive an allowance in the amount of an additional € 256,000. The children's maintenance allowance varies according to age.

Other allowances are available for household, certain personal belongings and most important business transfers. Under the current law, the allowance for business transfers amounts to € 225,000 and a flat adjustment of 35% from the net worth of the business may be applied. The new inheritance law foresees a flat adjustment of 85%, if the business entity meets certain conditions over a 15 year period: the sum of salaries stays stable over the next 10 years as well as the going concern of the business entity over the next 15 years.

Current inheritance and gift tax rates (in %)

Estate (tax value in €)	I	II	III
Up to 52,000	7	12	17
256,000	11	17	23
512,000	15	22	29
5,113,000	19	27	35
12,783,000	23	32	41
25,565,000	27	37	47
More than 25,565,000	30	40	50

Planned new inheritance and gift tax rates (in %)

Estate (tax value in €)	I	II	III
Up to 75,000	7	30	30
300,000	11	30	30
600,000	15	30	30
6,000,000	19	30	30
13,000,000	23	50	50
26,000,000	27	50	50
More than 26,000,000	30	50	50

8 Other Taxes

8.1 Real Estate Transfer Tax

Transactions in German real estate, which are usually exempt from German VAT, are subject to real estate transfer tax at a rate of 3.5% on the purchase price of the real estate.

Real estate transfer tax might play an important role in the restructuring of business entities. For example, a transfer of at least 95% of the shares of a corporation or partnership triggers real estate transfer tax on the entity’s real estate.

8.2 Property Tax (*Grundsteuer*)

Property tax is calculated annually with the help of the assessed value of land and buildings. The tax value of the property is multiplied by the basic rate which differs according to the type of property (agriculture and forestry, one-family house, two-family house, others). The basic rate is 0.35%. The result is then multiplied by a rate determined by the municipality where the property is situated.

8.3 Wealth Tax

Wealth tax has not been levied in Germany since January 1, 1997.

Part VIII
IP

The PCT and the Enforcement of Patents in Europe

K. Rupprecht

1 General Introduction

1.1 *Update of Countries*

Year by year, the PCT Community of member states is getting larger, since more and more countries recognize the usefulness and the advantages of the PCT for applicants. Use of the PCT saves time, work and money and eases the prosecution of a global patent strategy in a number of countries which has presently increased to 138 (Status on October 2007) contracting states in total.

1.2 *Some Statistics*

The problem with protecting innovations is well-known to all of us:

It has occurred many times that after filing a patent application, the invention is improved by new technical methods. Or in theory, the invention appears promising but the practical function is neither reliable nor good in maintenance or economical. Or it comes to notice at the end of the priority year that the sales or marketing department can not yet make the final selection of countries as the product has not yet been introduced on the market. Thus, more time is appreciated to make a final decision on the selection of countries for patent protection. Other important advantages resulting from using of the PCT route are referred to in the following, and interesting aspects are discussed hereinafter.

The number of International Patent Applications filed since 1985 increased almost like an e-function, reaching a total of applications in the year 2006 of about 140,000 (Fig. 1).

The U.S. ranks No. 1 ahead of Japan and Germany in terms of the filing numbers per country. Out of 26,906 applications from Japanese applicants in 2006, approximately 2,364 or 8.9% were filed in English. As far as the 50,089 PCT applications with U.S. origin are concerned, approximately 44% or 21,748 used the EPO as

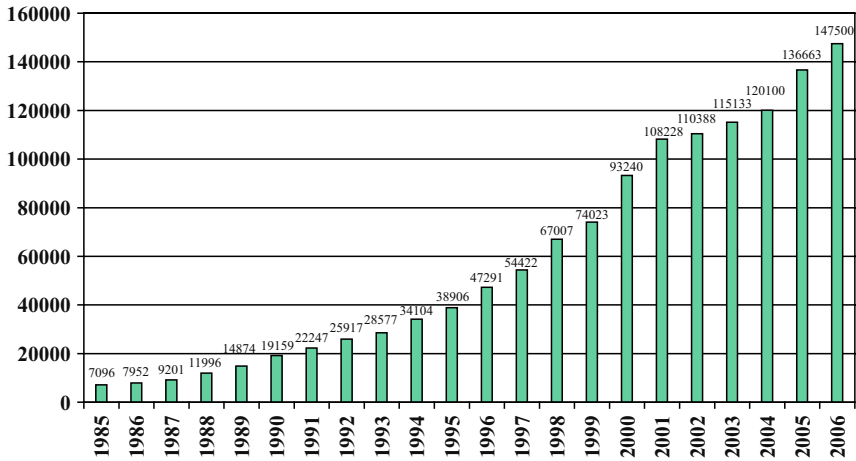


Fig. 1 Number of international patent applications

International Search Authority (ISA) and another 10% or 2,283 of these used the EPO also as International Preliminary Examination Authority (IPEA).

The following should encourage Japanese applicants to file their PCT applications in English, and Japanese and U.S. applicants to subsequently use the European Patent Office as ISA and, even more advantageously, as International Preliminary Examining Authority (IPEA). This is possible by inserting “EP” in box number VII of the PCT application form. U.S.-Companies may choose USPTO or WIPO as Receiving Office, in any case EPA as ISA and IPEA.

1.3 Designation System

Since January 1, 2004, for all International applications filed on or after January 1, 2004, an automatic and “all inclusive” designation system applies. Since then, the filing of a PCT application automatically includes the designation of all contracting states that can be designated on the international filing date, as well as every kind of protection which is available by way of the designation of that State and, last but not least, an indication that the International application is, in respect of each designated state if so permitted, for the grant of a regional patent, for a national patent (Tables 1–5).

Sheet No.

Box No. V DESIGNATIONS				
The filing of this request constitutes under Rule 4.9(a), the designation of all Contracting States bound by the PCT on the international filing date, for the grant of every kind of protection available and, where applicable, for the grant of both regional and national patents. However,				
<input type="checkbox"/> DE Germany is not designated for any kind of national protection <input type="checkbox"/> JP Japan is not designated for any kind of national protection <input type="checkbox"/> KR Republic of Korea is not designated for any kind of national protection <input type="checkbox"/> RU Russian Federation is not designated for any kind of national protection				
<i>(The check-boxes above may only be used to exclude (irrevocably) the designations concerned if, at the time of filing or subsequently under Rule 26bis.1, the international application contains in Box No. VI a priority claim to an earlier national application filed in the particular State concerned, in order to avoid the ceasing of the effect, under the national law, of this earlier national application.)</i>				
Box No. VI PRIORITY CLAIM				
The priority of the following earlier application(s) is hereby claimed:				
Filing date of earlier application (day/month/year)	Number of earlier application	Where earlier application is:		
		national application: country or Member of WTO	regional application: regional Office	international application: receiving Office
item (1) 21 January 2008 (21.01.2008)	11/888,777	US		
item (2) 1 February 2008 (01.02.2008)	03276543,2		EP	
item (3)				
<input type="checkbox"/> Further priority claims are indicated in the Supplemental Box.				
Transmit certified copy: the receiving Office is requested to prepare and transmit to the International Bureau a certified copy of the earlier application(s) (only if the earlier application was filed with the Office which for the purposes of this international application is the receiving Office) identified above as:				
<input type="checkbox"/> all items <input checked="" type="checkbox"/> item (1) <input type="checkbox"/> item (2) <input type="checkbox"/> item (3) <input type="checkbox"/> other, see Supplemental Box				
Restore the right of priority: the receiving Office is requested to restore the right of priority for the earlier application(s) identified above or in the Supplemental Box as item(s) (.....). (See also the Notes to Box No. VI; further information must be provided to support a request to restore the right of priority.)				
Incorporation by reference: where an element of the international application referred to in Article 11(1)(iii)(d) or (e) or a part of the description, claims or drawings referred to in Rule 20.5(a) is not otherwise contained in this international application but is completely contained in an earlier application whose priority is claimed on the date on which one or more elements referred to in Article 11(1)(iii) were first received by the receiving Office, that element or part is, subject to confirmation under Rule 20.6, incorporated by reference in this international application for the purposes of Rule 20.6.				
Box No. VII INTERNATIONAL SEARCHING AUTHORITY				
Choice of International Searching Authority (ISA) (if two or more International Searching Authorities are competent to carry out the international search, indicate the Authority chosen; the two-letter code may be used): ISA / EP				
Request to use results of earlier search; reference to that search (if an earlier search has been carried out by or requested from the International Searching Authority): Date (day/month/year) Number Country (or regional Office)				
Box No. VIII DECLARATIONS				
The following declarations are contained in Boxes Nos. VIII (i) to (v) (mark the applicable check-boxes below and indicate in the right column the number of each type of declaration):				Number of declarations
<input type="checkbox"/>	Box No. VIII (i)	Declaration as to the identity of the inventor	:	
<input checked="" type="checkbox"/>	Box No. VIII (ii)	Declaration as to the applicant's entitlement, as at the international filing date, to apply for and be granted a patent	:	
<input checked="" type="checkbox"/>	Box No. VIII (iii)	Declaration as to the applicant's entitlement, as at the international filing date, to claim the priority of the earlier application	:	
<input checked="" type="checkbox"/>	Box No. VIII (iv)	Declaration of inventorship (only for the purposes of the designation of the United States of America)	:	
<input type="checkbox"/>	Box No. VIII (v)	Declaration as to non-prejudicial disclosures or exceptions to lack of novelty	:	

Form PCT/RO/101 (second sheet) (April 2007)

See Notes to the request form

C	Receiving Offices	C
JP	JAPAN PATENT OFFICE	JP

Competent receiving Office for nationals and residents of:	Japan
Language in which international applications may be filed:	English or Japanese ¹
Language in which the request may be filed:	English or Japanese
Number of copies required by the receiving Office:	1
Does the receiving Office accept the filing of international applications with requests in PCT-EASY format? ²	Yes
Does the receiving Office accept the filing of international applications in electronic form? ³	Yes ⁴
Does the receiving Office accept requests for restoration of the right of priority (PCT Rule 26bis.3)?	No
Competent International Searching Authority:	European Patent Office ⁵ or Japan Patent Office
Competent International Preliminary Examining Authority:	European Patent Office ⁶ or Japan Patent Office ⁷
Fees payable to the receiving Office:	Currency: Japanese yen (JPY)
Transmittal fee:	JPY 13,000
International filing fee:	JPY 137,000
Fee per sheet in excess of 30:	JPY 1,500

[Continued on next page]

¹ If the language in which the international application is filed is not accepted by the International Searching Authority (see Annex D), the applicant will have to furnish a translation (PCT Rule 12.3).

² Where the request is filed in PCT-EASY format together with a PCT-EASY diskette and the receiving Office accepts such filings, the total amount of the international filing fee is reduced (see *PCT Gazette* No. 51/1998, pages 17330 and 17332, and No. 41/2006, page 19092, Schedule of Fees, item 3(a)).

³ Where the international application is filed in electronic form in accordance with and to the extent provided for in Part 7 and Annex F of the Administrative Instructions, the total amount of the international filing fee is reduced (see *PCT Gazette* No. 41/2006, page 19092, Schedule of Fees, items 3(c) and (d)).

⁴ For the relevant notification by the Japan Patent Office, refer to *PCT Gazette* No. 17/2004, pages 9452 *et seq.*

⁵ The European Patent Office is competent only if the international application is filed in English.

⁶ The European Patent Office is competent only if the international search is or has been performed by that Office.

⁷ The Japan Patent Office is competent only if the international search is or has been performed by that Office.

(1 January 2008)

C	Receiving Offices	C
US	UNITED STATES PATENT AND TRADEMARK OFFICE (USPTO)	US

[Continued]

Does the receiving Office accept requests for restoration of the right of priority (PCT Rule 26bis.3)?	Yes, the Office applies the “unintentional” criterion to such requests
Competent International Searching Authority:	European Patent Office ⁸ , Korean Intellectual Property Office or United States Patent and Trademark Office
Competent International Preliminary Examining Authority:	European Patent Office ^{8, 9} , Korean Intellectual Property Office or United States Patent and Trademark Office
Fees payable to the receiving Office: ¹⁰	Currency: US dollar (USD)
Transmittal fee:	USD 300
International filing fee:	USD 1,194
Fee per sheet in excess of 30:	USD 13
Reductions (under Schedule of Fees, item 3):	
PCT-EASY: ¹¹	USD 85
Electronic filing ¹² (without PCT-EASY zip file):	USD 85
Electronic filing ¹² (with PCT-EASY zip file):	USD 171
Search fee:	See Annex D(EP), (KR) or (US)
Fee for priority document (PCT Rule 17.1(b)):	USD 0 ¹³
Fee for requesting restoration of the right of priority (PCT Rule 26bis.3(d)):	USD 1,410
Is an agent required by the receiving Office?	No
Who can act as agent?	Patent attorneys and patent agents registered to practice before the Office. A list of registered patent attorneys and agents may be obtained on the Internet at http://des.uspto.gov/OEDCI/ .

[Continued on next page]

⁸ The availability of the European Patent Office as an International Searching Authority and/or International Preliminary Examining Authority is restricted. For details, see Annexes D(EP), E(EP), and *PCT Gazette* No. 07/2005, page 4432 and No. 38/2006, page 19670.

⁹ The European Patent Office is competent only if the international search is or has been performed by that Office.

¹⁰ The amounts of these fees change periodically. The receiving Office or the *Official Gazette of the United States Patent and Trademark Office—Patents* available at: www.uspto.gov/web/offices/com/sol/og/index.html should be consulted for the applicable amounts.

¹¹ See footnote 1.

¹² See footnote 2.

¹³ The fee is USD 20 for international applications filed before 31 August 2007.

(1 January 2008)

Form 3 Us patent and trademark office

Table 1 Member States

State	Date on which State became party to the Treaty
Albania	October 4, 1995
Algeria	March 8, 2000
Angola	December 27, 2007
Antigua and Barbuda	March 17, 2000
Armenia	December 25, 1991
Australia	March 31, 1980
Austria	April 23, 1979
Azerbaijan	December 25, 1995
Bahrain	March 18, 2007
Barbados	March 12, 1985
Belarus	December 25, 1991
Belgium	December 14, 1981
Belize	June 17, 2000
Benin	February 26, 1987
Bosnia and Herzegovina	September 7, 1996
Botswana BW	October 30, 2003
Brazil	April 9, 1978
Bulgaria	May 21, 1984
Burkina Faso	March 21, 1989
Cameroon	January 24, 1978
Canada	January 2, 1990
Central African Republic	January 24, 1978
Chad	January 24, 1978
China	January 1, 1994
Colombia	February 28, 2001
Comoros	April 3, 2005
Congo	January 24, 1978
Costa Rica	August 3, 1999
Cote d'Ivoire	April 30, 1991
Croatia	July 1, 1998
Cuba	July 16, 1996
Cyprus	April 1, 1998
Czech Republic	January 1, 1993
Democratic People's Republic of Korea	July 8, 1980
Denmark	December 1, 1978
Dominica	August 7, 1999
Dominican Republic DO	May 28, 2007
Ecuador	May 7, 2001
Egypt EG	September 6, 2003

Table 1 (Continued)

State	Date on which State became party to the Treaty
El Salvador SV	August 17, 2006
Equatorial Guinea GQ	July 17, 2001
Estonia	August 24, 1994
Finland	October 1, 1980
France	February 25, 1978
Gabon	January 24, 1978
Gambia	December 9, 1997
Georgia	December 25, 1991
Germany	January 24, 1978
Ghana	February 26, 1997
Greece	October 9, 1990
Grenada	September 22, 1998
Guatemala GT	October 14, 2006
Guinea	May 27, 1991
Guinea-Bissau	December 12, 1997
Honduras HN	June 20, 2006
Hungary	June 27, 1980
Iceland	March 23, 1995
India	December 7, 1998
Indonesia	September 5, 1997
Ireland	August 1, 1992
Israel	June 1, 1996
Italy	March 28, 1985
Japan	October 1, 1978
Kazakhstan	December 25, 1991
Kenya	June 8, 1994
Kyrgyzstan	December 25, 1991
Lao People's Democratic Republic LA	June 14, 2006
Latvia	September 7, 1993
Lesotho	October 21, 1995
Liberia	August 27, 1994
Libyan Arab Jamahiriya LY	September 15, 2005
Liechtenstein	March 19, 1980
Lithuania	July 5, 1994
Luxembourg	April 30, 1978
Madagascar	January 24, 1978
Malawi	January 24, 1978
Malaysia MY	August 16, 2006

(continued)

Table 1 (Continued)

State	Date on which State became party to the Treaty
Mali	October 19, 1984
Malta MT	March 1, 2007
Mauritania	April 13, 1983
Mexico	January 1, 1995
Monaco	June 22, 1979
Mongolia	May 27, 1991
Montenegro ME	June 3, 2006
Morocco	October 8, 1999
Mozambique	May 18, 2000
Namibia NA	January 1, 2004
Netherlands	July 10, 1979
New Zealand	December 1, 1992
Nicaragua NI	March 6, 2003
Niger	March 21, 1993
Nigeria	May 8, 2005
Norway	January 1, 1980
Oman OM	October 26, 2001
Papua New Guinea PG	June 14, 2003
Philippines PH	August 17, 2001
Poland	December 25, 1990
Portugal	November 24, 1992
Republic of Korea	August 10, 1984
Republic of Moldova	December 25, 1991
Romania	July 23, 1979
Russian Federation	March 29, 1978
Saint Kitts and Nevis KN	October 27, 2005
Saint Lucia	August 30, 1996
Saint Vincent and the Grenadines VC	August 6, 2002
Senegal	January 24, 1978
Serbia and Montenegro CS	February 1, 1997
Seychelles SC	November 7, 2002
Sierra Leone	June 17, 1997
Singapore	February 23, 1995
Slovakia	January 1, 1993
Slovenia	March 1, 1994
South Africa	March 16, 1999
Spain	November 16, 1989
Sri Lanka	February 26, 1982

Table 1 (Continued)

State	Date on which State became party to the Treaty
Sudan	April 16, 1984
Swaziland	September 20, 1994
Sweden	May 17, 1978
Switzerland	January 24, 1978
Syrian Arab Republic SY	June 26, 2003
Tajikistan	December 25, 1991
The former Yugoslav Republic of Macedonia	August 10, 1995
Togo	January 24, 1978
Trinidad and Tobago	March 10, 1994
Tunisia	December 10, 2001
Turkey	January 1, 1996
Turkmenistan	December 25, 1991
Uganda	February 9, 1995
Ukraine	December 25, 1991
United Arab Emirates	March 10, 1999
United Kingdom	January 24, 1978
United Republic of Tanzania	September 14, 1999
United States of America	January 24, 1978
Uzbekistan	December 25, 1991
Viet Nam	March 10, 1993
Zambia	November 15, 2001
Zimbabwe	June 11, 1997

1.4 Time Frame of a PCT Application

Once the PCT application has been filed, there are three crucial terms which have to be carefully surveyed. The first term is the term for filing a request for International Preliminary Examination and will expire either 3 month after the issuance of the International Search Report (ISR) and its written opinion or 22 months from the priority date, whichever expires later. The next crucial date is the entry of the National/Regional Phases, 30 or 31 months after the priority date (i.e. in practice 18 or 19 month after the PCT filing date). In some states this entry of the National/Regional Phases is extended to 30 or 31 months only if a request for International Preliminary Examination has been filed in time, namely when “Sect. *II*” has been entered before expiration of the 19 month term. Table 6 shows the applicable time limit for each PCT member state (Fig. 2).

Time Limits for entering National/Regional Phase under PCT Sects. 1 and 2 (in months from priority date, or from international filing date if there is no Priority claim) – as at July 2007.

Table 2 Number of applications per country (status Sept. 2007)

Country of origin	2002	2003	2004	2005	2006	Change compared with 2005 (%)
United States of America	41,296	41,029	43,350	46,772	50,089	7.1
Japan	14,063	17,414	20,264	24,864	26,906	8.2
Germany	14,326	14,662	15,216	16,009	16,866	5.4
France	5,089	5,171	5,185	5,745	6,109	6.3
Republic of Korea	2,520	2,949	3,558	4,687	5,935	26.6
United Kingdom	5,376	5,206	5,026	5,077	5,064	-0.3
Netherlands	3,977	4,479	4,284	4,514	4,452	-1.4
China	1,018	1,295	1,706	2,499	3,910	56.5
Switzerland	2,755	2,861	2,899	3,285	3,488	6.2
Sweden	2,990	2,612	2,851	2,877	3,312	15.1
Italy	1,982	2,163	2,189	2,346	2,721	16.0
Canada	2,260	2,270	2,104	2,315	2,470	6.7
Australia	1,759	1,680	1,837	1,994	1,989	-0.3
Finland	1,762	1,557	1,672	1,891	1,863	-1.5
Israel	1,174	1,129	1,227	1,456	1,584	8.8
All Others	8,045	8,722	9,259	10,308	10,742	4.2
Total	110,392	115,199	122,627	136,639	147,500	7.9

Source: WIPO statistics database

Table 3 Number of applications per ISA (status Feb. 2007)

Searching authority	2002	2003	2004	2005	2006	2006 (%)
European Patent Office	60,426	60,855	63,230	67,082	70,666	47.9
United States of America	25,525	26,476	26,885	28,551	29,126	19.7
Japan	13,161	16,142	18,695	23,020	25,386	17.2
Republic of Korea	2,247	2,595	3,211	4,230	6,645	4.5
Sweden	3,999	3,518	3,400	3,383	3,195	2.2
Australia	2,208	2,249	2,503	2,735	2,768	1.9
China	977	1,225	1,650	2,481	3,920	2.7
Canada	0	0	840	2,101	2,277	1.5
Spain	686	746	772	986	1,067	0.7
Austria	532	748	824	914	1,095	0.7
Russian Federation	625	641	615	720	695	0.5
Finland	0	0	0	426	648	0.4
Unknown	6	4	2	10	10	0.0
Total	110,392	115,199	122,627	136,639	147,500	100

Source: WIPO statistics database

Table 4 Number of applications per language (status Feb. 2007)

Language of filing	2006	Percent
English	89,206	60.5
Japanese	24,542	16.6
German	16,840	11.4
French	5,174	3.5
Korean	3,584	2.4
Chinese	3,510	2.4
Spanish	1,167	0.8
Italian	1,023	0.7
Russian	642	0.4
Dutch	506	0.3
Swedish	444	0.3
Finnish	418	0.3
Norwegian	173	0.1
Danish	140	0.1
Hungarian	41	<0.1
Slovenian	22	<0.1
Turkish	17	<0.1
Czech	16	<0.1
Portuguese	11	<0.1
Croatian	11	<0.1
Slovak	8	<0.1
Other	8	<0.1
Total	147,500	100

Source: WIPO statistics database

Table 5 Number of demands per IPEA (status Feb. 2007)

Examining authority	2002	2003	2004	2005	2006	2006 (%)
European Patent Office	41,054	31,472	21,681	13,899	11,391	54.2
United States of America	24,685	20,165	11,553	5,512	3,543	16.9
Japan	7,076	6,816	4,209	2,527	2,584	12.3
Australia	1,855	1,693	1,250	1,038	971	4.6
Sweden	3,462	2,618	1,618	986	685	3.3
Republic of Korea	1,367	1,079	934	651	600	2.9
Canada			1	322	419	2.0
China	675	669	501	438	347	1.7
Finland				4	127	0.6
Austria	258	239	148	160	112	0.5
Spain		8	129	128	111	0.5
Russian Federation	379	212	162	138	109	0.5
Total	80,811	64,971	42,186	25,803	21,000	100

Source: WIPO statistics database

Table 6 PCT-time limits

DO/EO ^a	Section 1	Section 2	DO/EO	Section 1	Section 2	DO/EO	Section 1	Section 2
Regional offices			National offices			National offices		
AP	31 ^b	31 ^c	HU ^d	31 ^b	31 ^c	RO ^d	30	30
EA	31 ^b	31 ^c	ID	30	31 ^c	RS	30 ^e	30 ^e
EP	31 ^b	31 ^c	IL	30	30	RU ^f	31 ^b	31 ^c
OA	30	30	IN	31 ^b	31 ^c	SC ^g	30	30
National offices			IS	31	31	SD ^h	30	30
AE	30	30	JP	30	30	SE ^d	20 ⁱ	30
AG ^g	30	30	KE ^h	30	30	RO ^d	30	30
AL	30	31 ^c	KG ^f	31 ^b	31 ^c	RS	30 ^e	30 ^e
AM ^f	30	31 ^c	KM ^g	30	30	RU ^f	31 ^b	31 ^c
AT ^d	30	30	KP	30	30	SD ^h	30	30
AU	31 ^b	31 ^c	KR	30	30	SE ^d	20 ⁱ	30
AZ ^f	30	31 ^c	KZ ^f	31 ^b (33)	31 ^c (33)	SG	30	30
BA	34 ^b	34 ^e	LA ^g	30	30	SI ^d	31 ^b	31 ^c
BB	30	30	LC ^g	30	30	SK ^d	31 ^b	31 ^c
BG ^d	31 ^b	31 ^c	LK	30	30	SL ^h	30	31 ^c
BH ^g	30	30	LR	30	31 ^c	SM	31 ^b	31 ^c
BR	30	30	LS ^h	30	31 ^c	SV ^g	30	30
BW ^h	30	30	LT	31 ^b	31 ^c	SY	31 ^b	31 ^c
BY ^f	31 ^b	31 ^c	LU ^d	20 ⁱ	30	TJ ^f	30	31 ^c
BZ	30	30	LY ^g	30	30	TM ^f	30	31 ^c
CA	30 (42)	30 (42)	LV	31 ^b	31 ^c	TN ^g	30	30
CH ^d	20 ⁱ	30	MA	31	31 ^c	TR ^d	30 (33)	30 (33)
CN	30	30	MD ^f	31 ^b	31 ^c	TT	30	31 ^c
CO	31 ^b	31 ^c	ME ^g	30	30	TZ ^h	21 ^{b, i}	31 ^c
CR	31 ^b	31 ^c	MG	30	30	UA	31 ^b	31 ^c
CU	30	30	MK	31 ^b	31 ^c	UG ^h	21 ^{b, i}	31 ^c
CZ ^d	31 ^b	31 ^c	MN	30	31 ^c	US	30	30
DE ^d	30	30	MW ^h	30	30	UZ	30	31 ^c
DK ^d	31	31	MX	30	30	VC	30	30
DM ^g	30	30	MY ^g	30	30	VN	31 ^b	31 ^c
DO ^g	30	30	MZ ^h	30	31 ^c	YU	30	30
DZ	31 ^b	31 ^c	NA ^g	30	30	ZA	31 ^b	31 ^c
EC	31 ^b	31 ^c	NG	30	30	ZM ^h	20 ⁱ	30

Table 6 (Continued)

DO/EO ^a	Section 1	Section 2	DO/EO	Section 1	Section 2	DO/EO	Section 1	Section 2
EE ⁶	31 ^b	31 ^c	NI ^g	30	30	ZW ^h	30	31 ^c
EG ^g	30	30	NO	31 ^b	31 ^c			
ES ^d	30	30	NZ	31 ^b	31 ^c			
FI ^d	31	31	OM ^g	30	30			
GB ^d	31 ^b	31 ^c	31	31	30			
GD ^g	30	30	PH	30 (31)	30 (31)			
GE	31 ^b	31 ^c	NI ^g	30	30			
GH ^h	30	30	NO	31 ^b	31 ^c			
GM ^h	30	31 ^c	NZ	31 ^b	31 ^c			
GT ^g	30	30	OM ^g	30	30			
HN ^g	30	30	PL ^d	30	30			
HR	31 ^b	31 ^c	PT ^d	30	30			

^a Designated office/elected office

^b This time limit has been fixed in accordance with PCT Article 22(3)

^c This time limit has been fixed in accordance with PCT Article 39(1)(b)

^d If designated/elected for a European patent, see EP as DO/EO for the applicable time limits

^e The time limit can be extended by 30 days if the applicant pays an additional fee for late entry into the national phase

^f If designated/elected for a Eurasian patent, see EA as DO/EO for the applicable time limits

^g In the absence of information from the Office concerned, the time limits shown are those which would normally apply under PCT Articles 22(1) and 39(1)(a). If the Office decides to apply longer time limits, that information will be published in the *PCT Newsletter*

^h If designated/elected for an ARIPO patent, see AP as DO/EO for the applicable time limits

ⁱ This Office has notified the International Bureau of the non-applicability of the new time limit under PCT Articles 22(1) of 30 months, as modified with effect from 1 April 2002

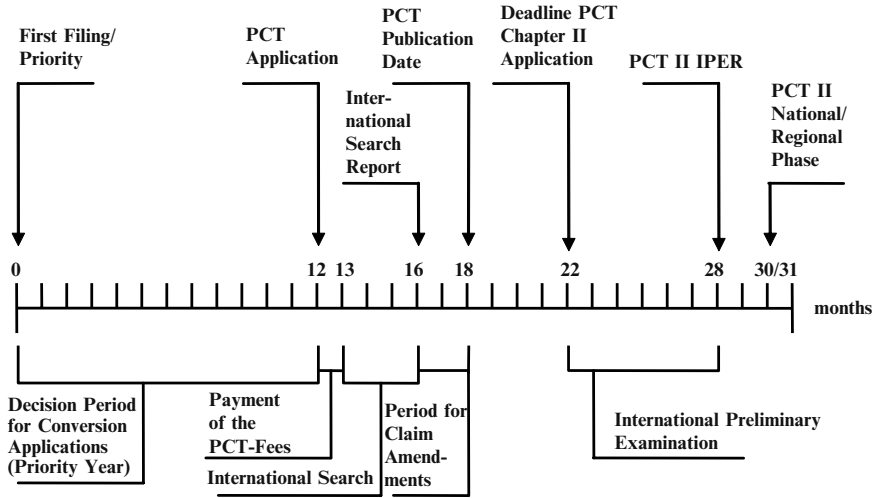


Fig. 2 PCT-terms



Fig. 3 WIPO-site

Useful information from the WIPO's Internet site may be retrieved as shown in the following (Fig. 3).

2 Filing of PCT Patent Applications

2.1 Claim Drafting Under the PCT and the EPC

A granted patent confers an exclusive right upon the patentee and reserves various commercial advantages. Hence, particular attention should be paid when drafting patent claims, since they define the scope of protection granted by the exclusive right. Also, care should be taken to obtain smoothly a complete search report and to avoid unnecessary formal problems due to an inexpedient approach of the wording.

In order to obtain a more detailed insight into patent claims in their structure under the PCT and the European patent system, the following legal provisions relating to patent claims and comment on the situation thereafter are provided.

As is well known, the PCT and the EPC are very much interrelated with each other, and a great deal of practical PCT work, in particular searches and preliminary examination, is carried out by the European Patent Office. Moreover, many PCT applications are later prosecuted as EPC applications. Therefore, in the following, particular attention is paid to the EPC provisions which are also applied by the EPO in the PCT procedure.

2.2 Case Papers

According to PCT and EPC law, a patent application must contain the following components:

- Request for grant
- Description
- One or more patent claims
- Drawings, if any

2.3 Unity of Invention

2.3.1 General Remarks Considering Both the PCT and the EPC

The term “unity of invention” is an essential administrative regulation in the PCT and European patent system which must be taken into account when drafting patent claims. The aim is always the same, namely to avoid separate inventions being covered by one and the same patent.

Under European law, the legal provisions are very detailed. The principle is defined in Article 82 EPC:

“The European patent application shall relate to one invention only or to a group of inventions so linked as to form a single general inventive concept.”

Further details are set forth in Rules 43 and 44 EPC as follows:

Rule 43:

Form and content of claims

- (1) The claims shall define the matter for which protection is sought in terms of the technical features of the invention. Wherever appropriate, claims shall contain:
 - (a) A statement indicating the designation of the subject-matter of the invention and those technical features which are necessary for the definition of the claimed subject-matter but which, in combination, form part of the prior art;
 - (b) A characterising portion, beginning with the expression “characterised in that” or “characterised by” and specifying the technical features for which, in combination with the features stated under sub-paragraph (a), protection is sought.
- (2) Without prejudice to Article 82, a European patent application may contain more than one independent claim in the same category (product, process, apparatus or use) only if the subject-matter of the application involves one of the following:
 - (a) A plurality of interrelated products
 - (b) Different uses of a product or apparatus
 - (c) Alternative solutions to a particular problem, where it is inappropriate to cover these alternatives by a single claim
- (3) Any claim stating the essential features of an invention may be followed by one or more claims concerning particular embodiments of that invention.
- (4) Any claim which includes all the features of any other claim (dependent claim) shall contain, if possible at the beginning, a reference to the other claim and then state the additional features. A dependent claim directly referring to another dependent claim shall also be admissible. All dependent claims referring back to a single previous claim, and all dependent claims referring back to several previous claims, shall be grouped together to the extent and in the most appropriate way possible.
- (5) The number of claims shall be reasonable with regard to the nature of the invention claimed. The claims shall be numbered consecutively in Arabic numerals.
- (6) Except where absolutely necessary, claims shall not rely on references to the description or drawings in specifying the technical features of the invention. In particular, they shall not contain such expressions as “as described in part ... of the description”, or “as illustrated in figure ... of the drawings”.
- (7) Where the European patent application contains drawings including reference signs, the technical features specified in the claims shall preferably be followed by such reference signs relating to these features, placed in parentheses, if the intelligibility of the claim can thereby be increased. These reference signs shall not be construed as limiting the claim.

See decisions of the Enlarged Board of Appeal G 2/03, G 1/04 (Annex I).

Rule 44:

- (1) Where a group of inventions is claimed in one and the same European patent application, the requirement of unity of invention referred to in Article 82 EPC shall be fulfilled only when there is a technical relationship among those inventions involving one or more of the same or corresponding special technical features. The expression “special technical features” shall mean those features which define a contribution which each of the claimed inventions considered as a whole makes over the prior art;
- (2) The determination whether a group of inventions is so linked as to form a single general inventive concept shall be made without regard to whether the inventions are claimed in separate claims or as alternatives within a single claim.

With respect to the PCT search, in particular when carried out by the European Patent Office, it is not appropriate to use claims in the U.S. format with several independent claims approaching the invention from various sides with partly overlapping coverage. In most cases, such claims will lead to the following disadvantages:

Incomplete search report

- Invitation to pay further search fee(s)
- Delay in prosecution and time pressure
- With respect to the 20 month period

Rather, the following is highly recommended to avoid unity objections:

- Only one independent claim per category (product, method and apparatus, where appropriate), see Rule 43
- Reasonable number of sub-claims for each independent claim using multiple dependencies. (Reference signs in all the claims support the understanding and are highly recommended)

Such claims will result in one complete search report relating to all claims without additional search fees. The applicant has still all options to modify the claims during prosecution.

2.3.2 Consideration of Unity by the European Patent Office Under “EPC 2000”

General Remarks

In the revised version of EPC (EPC 2000), Rule 164 EPC stipulates:

- (1) Where the European Patent Office considers that the application documents which are to serve as the basis for the supplementary search do not meet the requirements of unity of invention, a supplementary search report shall be

drawn up on those parts of the application which relate to the invention, or the group of inventions within the meaning of Article 82, first mentioned in the claims;

- (2) Where the examining division finds that the application documents on which the European grant procedure is to be based do not meet the requirements of unity of invention, or protection is sought for an invention not covered by the international search report or, as the case may be, by the supplementary search report, it shall invite the applicant to limit the application to one invention covered by the international search report or the supplementary search report.

In general, for each European part of an international (PCT) application, the EPO will draw up a supplementary European search report. The Administrative Council, however, had decided according to Article 153(7) that a supplementary European search report is not drawn up for international applications:

- (i) For which the EPO was the International Searching Authority; or
- (ii) For which the Swedish, Austrian or Spanish Patent Office was the International Searching Authority and where the international application was filed before July 1, 2005 (OJ 1/1979, 4; OJ 2/1979, 50; OJ 6–7/1979, 248; OJ 8/1995, 511)

International Applications for Which No Supplementary Search is Conducted

If no supplementary search is conducted, e.g. in case of an international application for which the EPO was the International Searching Authority, the international (PCT) search report – if already available – will take the place of the European search report. Hence, for such cases, the revised version of Rule 164 EPC seems to have no influence.

Rather, when in an international (PCT) search a problem of unity of invention arises, according to Article 17(3) (a) PCT, the EPO acting as International Search Authority will inform the applicant of the lack of unity of invention in a communication accompanying the partial search report and indicating that a further search fee must be paid for each invention other than the one first mentioned in the claims, if the international search is to cover these inventions as well. Otherwise, the international search report will (only) be based on the invention or group of inventions first mentioned in the claims serving as basis for the international search.

Of course, if the applicant does not agree with the objected lack of unity of invention, in the international phase, the additional search fee(s) can be paid under protest. In this respect, the European Patent Office will examine the protest in accordance with Rule 40.2(c)–(e) or Rule 68.3(c)–(e) PCT, subject to payment of a prescribed protest fee.

In the international phase, however, the applicant has always the opportunity to request further searches in response to the finding of a lack of unity, even if the EPO carries out the international search (see Rule 158 EPC) because for the European search practice as regards international (PCT) searches, reference is made to the regulations of the PCT and not of the EPC.

International Applications for Which a Supplementary Search is Conducted

The opportunity to request further searches in response to the finding of a lack of unity, however, does not exist in the revised version of EPC (EPC 2000). In other words, where a supplementary search is conducted by the EPO in respect of European regional phase applications (Euro-PCT-applications), the revised version of Rule 164 EPC stipulates that the EPO will always draw up a (final) supplementary Search Report on those parts of the application which relates to the invention first mentioned in the claims. Please note that this will happen even if a lack of unity objection arises for the first time in the European regional phase.

Hence, even if a lack of unity objection arises for the first time in the European regional phase, without any prior warning in the international phase, the applicant is left with only one option, i.e. to pursue the invention first mentioned in the claims as determined by the EPO. If the applicant, however, is interested in covering an invention other than the invention first mentioned in the claims, a divisional application must be filed.

In order to avoid that the subject-matter of the application will be “automatically” restricted by the EPO to the invention first mentioned in the claims the applicant has two options which should be briefly discussed in the following:

Option 1

The revised version of Rule 161 EPC stipulates that, after entering the regional phase before the EPO, the application may be amended once, within 1 month from a Communication informing the applicant accordingly. The application as amended shall serve as the basis for any supplementary search which has to be performed by the EPO in respect of European regional phase applications (Euro-PCT-applications).

In this respect, Rule 161 EPC gives us the opportunity to adapt the claims of a European regional phase application (Euro-PCT-application) according to the European practice, in particular, with respect to the requirement of unity of invention.

Hence, the first option having the applicant for avoiding that the subject-matter of a European regional phase application will be “automatically” restricted by the EPO is to carefully study the claims of an international application with respect of unity of invention, and – if necessary – to redraft the claims accordingly before entering the regional phase before the EPO or after receipt of the Communication according to Rule 161 EPC. In this matter, it should be possible to avoid lack of unity directly evident a priori, i.e. before considering the claims in relation to the prior art. Objections of lack of unity which only become apparent a posteriori, i.e. after taking the prior art into consideration, however, again cannot be avoided.

If lack of unity becomes apparent a posteriori the EPO, however, will again draw up a (final) supplementary Search Report on those parts of the European regional phase application which relates to the invention first mentioned in the claims. Hence, in such a case, the subject-matter of the European regional phase

application will again be “automatically” restricted by the EPO to the invention first mentioned in the claims.

Option 2

The second option having the applicant for avoiding that the subject-matter of the European regional phase application will be “automatically” restricted by the EPO is, when filing the international application, to explicitly select in the PCT request the EPO as International Search Authority. In this case, Article 17(3) (a) PCT applies which stipulates that the EPO acting as International Search Authority must inform the applicant of a lack of unity of invention in a Communication and indicating that a further search fee must be paid for each invention other than the one first mentioned in the claims, if the international search is to cover these inventions as well. Hence, after payment of the requested additional search fee(s), for all inventions or group of inventions covered by the originally filed claims a separate international search report will be drawn up. Thereafter, the applicant has the opportunity to select one invention or one group of invention, on the basis of which the regional phase before the EPO should be entered.

2.3.3 Unity of Invention in Practice

General Remarks

A European application must “relate to one invention only or to a group of inventions so linked as to form a single general inventive concept” (Article 82 EPC). The second of these alternatives, i.e. the single-concept linked group, may give rise to a plurality of independent claims in the same category provided these claims comply with Rule 43(2) EPC, but the more usual case is a plurality of independent claims in different categories.

Special Technical Features

Rule 44(1) EPC indicates how one determines whether or not the requirement of Article 82 EPC is fulfilled when more than one invention appears to be present. The link between the inventions required by Article 82 EPC must be a technical relationship which finds expression in the claims in terms of the same or corresponding special technical features. The expression “special technical features” means, in any one claim, the particular technical feature or features that define a contribution that the claimed invention considered as a whole makes over the prior art. Once the special technical features of each invention have been identified, one must determine whether or not there is a technical relationship between the inventions and, furthermore, whether or not this relationship involves these special technical features.

It is not necessary that the special technical features in each invention be the same. Rule 44(1) EPC makes clear that the required relationship may be found

between corresponding technical features. An example of this correspondence is the following: in one claim the special technical feature which provides resilience is a metal spring, whereas in another claim it is a block of rubber.

A plurality of independent claims in different categories may constitute a group of inventions so linked as to form a single general inventive concept. In particular, Rule 44(1) EPC should be construed as permitting the inclusion of any one of the following combinations of claims of different categories in the same application:

- (i) In addition to an independent claim for a given product, an independent claim for a process specially adapted for the manufacture of the said product, and an independent claim for a use of the said product; or
- (ii) In addition to an independent claim for a given process, an independent claim for an apparatus or means specifically designed for carrying out the said process; or
- (iii) In addition to an independent claim for a given product, an independent claim for a process specially adapted for the manufacture of the said product and an independent claim for an apparatus or means specifically designed for carrying out the said process

While a single set of independent claims according to any one of the combinations (i), (ii) or (iii) above is always permissible, however, a plurality of such sets of independent claims in one European patent application can only be allowed if the specific circumstances defined in Rule 43(2)(a)–(c) EPC apply and the requirements of Article 82 EPC and Article 84 EPC are met. The proliferation of independent claims arising out of a combined effect of this kind may therefore be allowed only exceptionally.

Moreover, it is essential that a single general inventive concept links the claims in the various categories. The presence in each claim of expressions such as “specially adapted” or “specifically designed” does not necessarily imply that a single general inventive concept is present.

In combination (i) above, the process is specially adapted for the manufacture of the product if the claimed process results in the claimed product, i.e. if the process is actually suited to making the claimed product accessible and thereby defines a technical relationship as defined in Rule 44(1) EPC between the claimed product and the claimed process (see W 11/99, OJ 4/2000, 186). A manufacturing process and its product may not be regarded as lacking unity simply by virtue of the fact that the manufacturing process is not restricted to the manufacture of the claimed product.

In combination (ii) above, the apparatus or means is specifically designed for carrying out the process if the apparatus or means is suitable for carrying out the process and thereby defines a technical relationship as defined in Rule 44(1) EPC between the claimed apparatus or means and the claimed process. It is not sufficient for unity that the apparatus or means is merely capable of being used in carrying out the process. On the other hand, it is of no importance whether or not the apparatus or means could also be used for carrying out another process or the process could also be carried out using an alternative apparatus or means.

Please note, however, that objection of lack of unity does not arise because of one claim containing a number of individual features, where these features do not present a technical inter-relationship (i.e. a combination), but merely a juxtaposition.

3 The International Search Report

3.1 Contents

Since January 1, 2004, the International Search Report (ISR) contains the usual citation of the documents considered relevant, a categorization of these documents according to their pertinence (e.g. “X”, “Y” or “A”) and a preliminary and non-binding written opinion on the questions of whether the claimed invention appears to meet the requirements of novelty, inventiveness and industrial applicability. This written opinion is part of the new “Enhanced International Search and Preliminary Examination” – system (EISPE-system) and will become the “International Preliminary Report on Patentability” (IPRP Sect. 1), if the applicant does not file a request for International Preliminary Examination Proceedings.

This written opinion is in fact very similar in scope to the written opinion used in earlier International Preliminary Examination proceedings. It may also play a certain role in the International Preliminary Examination proceedings under Sect. 2 PCT, which will be explained in Sect. 4.2 herein after. However, the main difference between this Sect. 1 written opinion and the written opinion issued during Sect. 2 proceedings is that the written opinion attached to the ISR does not open a dialog between the applicant and the examiner, whereas such dialog is possible during International Preliminary Examination proceedings. However, informal comments on the written opinion may be filed. The International Search Report (ISR) will be published, *without* said written opinion.

If the applicant does *not* file a valid request for International Preliminary Examination, the International Bureau in Geneva will establish the before-mentioned “International Preliminary Report on Patentability” (IPRP Sect. 1) on the basis of said written opinion prepared by the International Search Authority (ISA). The IPRP Sect. 1 and eventual comments thereto filed by the applicant will be submitted to all designated offices and will be made publicly accessible, but will not be published like the application and the International Search Report itself, and not before the expiration of 30 month from the priority date.

3.2 Amendments to the Application

As the questions of amendments to the International Application are always a big issue, the following table shows various possibilities and some restrictions.

PATENT COOPERATION TREATY

PCT

INTERNATIONAL SEARCH REPORT

(PCT Article 18 and Rules 43 and 44)

Applicant's or agent's file reference	FOR FURTHER ACTION see Form PCT/ISA/220 as well as, where applicable, item 5 below.	
International application No.	International filing date (<i>day/month/year</i>)	(Earliest) Priority Date (<i>day/month/year</i>)
Applicant		

This international search report has been prepared by this International Searching Authority and is transmitted to the applicant according to Article 18. A copy is being transmitted to the International Bureau.

This international search report consists of a total of _____ sheets.

It is also accompanied by a copy of each prior art document cited in this report.

1. Basis of the report

a. With regard to the **language**, the international search was carried out on the basis of:

the international application in the language in which it was filed.

a translation of the international application into _____ which is the language of a translation furnished for the purposes of international search (Rules 12.3(a) and 23.1(b)).

b. This international search report has been established taking into account the **rectification of an obvious mistake** authorized by or notified to this Authority under Rule 91 (Rule 43.6bis(a)).

c. With regard to any **nucleotide and/or amino acid sequence** disclosed in the international application, see Box No. I.

2. **Certain claims were found unsearchable** (see Box No. II).

3. **Unity of invention is lacking** (see Box No. III).

4. With regard to the **title**,

the text is approved as submitted by the applicant.

the text has been established by this Authority to read as follows:

5. With regard to the **abstract**,

the text is approved as submitted by the applicant.

the text has been established, according to Rule 38.2, by this Authority as it appears in Box No. IV. The applicant may, within one month from the date of mailing of this international search report, submit comments to this Authority.

6. With regard to the **drawings**,

a. the figure of the **drawings** to be published with the abstract is Figure No. _____

as suggested by the applicant.

as selected by this Authority, because the applicant failed to suggest a figure.

as selected by this Authority, because this figure better characterizes the invention.

b. none of the figures is to be published with the abstract.

Form PCT/ISA/210 (first sheet) (April 2007) (Revised)

Form 4 International search report

According to Article 19 PCT, the applicant has one opportunity to amend the claims of the International Application. Upon receipt of the International Search Report, there will be another opportunity for amendments to the claims, description and drawings during the International Preliminary Examination Procedure, according to Article 34 PCT. Amendments to the claims could be advisable if the prior art cited in the International Search Report is so close to the application as claimed that it is desirable to enter either the International Preliminary Examination Procedure or the national/regional examination procedure, with fresh claims in order to decrease the time needed for substantive examination.

(a) What parts of the International Application may be amended?

As a reaction to the International Search Report, the claims may be amended only once (Article 19 PCT). However, only during the International Preliminary Examination and upon entry into the National or Regional Phase, all parts of the International Application may be amended.

(b) Deadline for Amendment

The International Application can be amended within 2 months from the date of transmittal of the International Search Report or within 16 months from the priority date, whichever time limit expires later. However, it should be noted, that the amendments will also be considered as having been received in time if they are received by the International Bureau, even after the expiration of the applicable time limit, but before the completion of the technical preparations for the International Publication (15 days).

(c) Where to file the amendments?

The amendments may only be filed directly with the
International Bureau of WIPO
34, Chemin des Colombettes,
CH-1211 Geneva 20,
Switzerland

and not with the Receiving Office or the International Searching Authority (Rule 46.2 PCT).

Remark: Where a demand for International Preliminary Examination has been filed or is filed, the applicant must preferably, at the same time of filing the amendments with the International Bureau, also file a copy of such amendments with the International Preliminary Examining Authority (Rule 62.2(a), first sentence PCT).

(d) How to file the amendments?

Either by canceling one or more claims entirely, by adding one or more new claims or by amending the text of one or more of the claims as filed. A replacement sheet must be submitted for each sheet of the claims which, on account of an amendment or amendments, differs from the sheet as originally filed. All the claims appearing on a replacement sheet must be numbered in Arabic numerals. Where a claim is cancelled, no renumbering of the other claims is required. In all cases where claims are renumbered, they must be renumbered consecutively. The U.S. system of canceling, e.g. claims 1–12 and filing new claims 13–24 is not applicable.

The amendments must be made in the language in which the International Application is to be published.

(e) What documents must or may accompany the amendments?

The amendments must be submitted with an accompanying letter which will not be published with the International Application. This accompanying letter should not be confused with the “Statement under Article 19(1)” which will be explained hereinafter. The accompanying letter just serves to clarify in a more formal way which claims remain unchanged, which claims are being cancelled, which claims are new, and which claim shall replace which claim.

The Statement under Article 19(1) PCT and according to Rule 46.4 PCT may be added and should explain the amendments and indicate any impacts that such amendments might have on the description and the drawings. This Statement will be published with the International Application and the amended claims. It must be in the language in which the International Application is to be published and must not exceed 500 words.

(f) Consequence with regard to the translation of the International Application upon entry into the National/Regional Phase.

Article 19 PCT

Amendment of the Claims before the International Bureau

- (1) The applicant shall, after having received the international search report, be entitled to one opportunity to amend the claims of the international application by filing amendments with the International Bureau within the prescribed time limit. He may, at the same time, file a brief statement, as provided in the Regulations, explaining the amendments and indication any impact that such amendments might have on the description and the drawings
 - (2) The amendments shall not go beyond the disclosure in the international application as filed
 - (3) If the national law of any designated State permits amendments to go beyond the said disclosure, failure to comply with paragraph (2) shall have no consequence in that State
-

Statute 1 – Article 19 PCT

3.2.1 Fee Reductions

The following table shows a breakdown of the official fees for an International Application including the International Search, the International Preliminary Examination, the subsequent Examination and the supplementary search at the European Patent Office.

Case (a) denotes entering the Regional Phase at the EPO under the condition that the International Search and the International Preliminary Examination were carried out by the EPO; case (b) denotes entering the Regional Phase at the EPO under the condition that the International Search was carried out by the EPO, but the International Preliminary Examination by the JPO; case (c) denotes entering the

Regional Phase at the EPO under the condition that the International Search was carried out by the EPO, but the International Preliminary Examination by the USPTO; case (d) denotes entering the Regional Phase at the EPO under the condition that the International Search and the International Preliminary Examination were carried out by the JPO; case (e) denotes entering the Regional Phase at the EPO under the condition that the International Search and the International Preliminary Examination were carried out by the USPTO.

Remark: International Preliminary Examination at the EPO presupposes that the EPO also performed the International Search.

Fee reductions are applicable in all five cases, but in a different way: Article 157(2)(a) EPC provides that a Supplementary European Search Report shall be drawn up in respect of all International Applications. However, Article 157(3) EPC says that the Administrative Council of the EPO may decide under what conditions and to what extent the EPO can waive the necessity of a Supplementary European Search Report or the Supplementary Search fee is to be reduced. This has been done in terms of the Japanese Patent Office and the U.S. Patent and Trademark Office in case (d) and (e), where the Supplementary Search fee is reduced by EUR 190.00. In cases (a), (b) and (c) however, where the EPO has drawn up the International Search Report, no Supplementary Search fee is due. In case (a), where the EPO has conducted the International Preliminary Examination and has drawn up an International Search Report, the examination fee upon entering the Regional Phase is being reduced by 50%. This cost advantage and others will be addressed again in Sect. 4 dealing with the International Preliminary Examination Procedure.

Conclusion: The way over the EPO as International Search Authority (ISA) and International Preliminary Examination Authority (IPEA) is more expensive than the way over the JPO for Japanese applicants or over the USPTO for U.S. applicants. Nevertheless, the way over the EPO as ISA *and* IPEA has considerable merits as will be elucidated in Sect. 4.3 hereinafter.

3.3 International Scope of Prior Art Considered in the International Search Report

The International Searching Authority shall endeavor to discover as much of the relevant prior art as its facilities permit, and shall, in any case, consider the documentation specified in the PCT Regulations (Article 15(4) PCT). This is the official definition of a so-called “minimum documentation”, which shall consist of the prior art documents as shown in the following.

The minimum documentation forming the basis of an International Search shall consist of:

- The patents issued in and after the year 1920 by France, the former *Reichspatentamt* of Germany, Japan, the former Soviet Union, Switzerland (in French and German languages only), the United Kingdom and the United States of America

- The patents issued by the Federal Republic of Germany
- The patent applications published in and after the year 1920 in the aforementioned countries
- The inventors certificates issued by the former Soviet Union
- The utility certificates issued by, and the published applications for utility certificates of France
- Such patents issued by, and such patent applications published in any other country after the year 1920 as are in the English, French or Spanish language and in which no priority is claimed, provided that the national office of the interested country does sort out these documents and place them at the disposal of the International Searching Authorities
- The published International (PCT) applications, the published regional applications for patents and inventors certificates, and the published regional patents and inventors certificates
- Selected items of non-patent literature

Article 157 EPC

International Search Report

- (1) Without prejudice to the provisions of paragraphs 2–4, the international search report under Article 18 of the Cooperation Treaty or any declaration under Article 17, paragraph 2(a), of that Treaty and their publication under Article 21 of that Treaty shall take place of the European search report and the mention of its publication in the European Patent Bulletin
- (2) Subject to the decisions of the Administrative Council referred to in paragraph 3:
 - (b) A supplementary European search report shall be drawn up in respect of all international applications.
 - (c) The applicant shall pay the search fee, which shall be paid at the same time as the national fee provided for in Article 22, paragraph 1, or Article 39, paragraph 1, of the Cooperation Treaty. If the search fee is not paid in due time the application shall be deemed to be withdrawn.
- (3) The Administrative Council may decide under what conditions and to what extent:
 - (a) *The supplementary European search report is to be dispensed with
 - (b) **The search fee is to be reduced
- (4) The Administrative Council may at any time rescind the decisions taken pursuant to paragraph 3

*See the decisions of the Administrative Council of 21.12.1978, 17.05.1979 and 09.06.1995 on cases where the Supplementary European Search Report is to be dispensed with (OJ EPO 1979, 4, 50 and 248; 1995, 511)

**See the decisions of the Administrative Council of 14.09.1979, 11.12.1980 and 09.12.1993 on the reduction of the Search fee for the Supplementary European Search Report (OJ EPO 1979, 368; 1981, 5; 1994, 6)

4 The International Preliminary Examination Procedure

4.1 *Advantages of International Preliminary Examination*

When the end of the priority year approaches, the question is:

In which countries shall foreign applications be filed?

In many cases a final selection is not possible at this early stage. A PCT application already grants a postponement of the entry of the National or Regional Phases for 18 or 19 months. Going “Sect. 2”, i.e. applying for International Preliminary Examination, may be advisable under the following considerations:

There are basically two major arguments in favor of International Preliminary Examination:

- (a) Getting a preliminary and non-binding opinion on the questions whether the claimed invention appears to be novel, to involve an inventive step (i.e. to be non-obvious), and to be industrially applicable; and
- (b) Further amendments of the application are possible

As of April 1, 2002, almost all national and regional offices grant a postponement of the due date for the National/Regional Phase until 30/31 month from the priority date, irrespective of the condition that International Preliminary Examination (“Sect. 2”) has been entered by filing a Demand before the expiry of the corresponding deadline.

Advantage (a), i.e. the preliminary and non-binding opinion by the International Preliminary Examining Authority (IPEA), has two impacts: first of all, it can serve as a basis for the decision, where the National or Regional Phases should be entered because it enables the applicant to make an assessment of the chances to get a patent granted. Secondly, since the criteria on which the International Preliminary Examination is based correspond to internationally accepted criteria for patentability, the International Preliminary Examination Report (IPER) will of course influence the National/Regional examiners who will be provided with the IPER by the International Bureau.

Advantage (b) is apparent from Table 7 – Amendments to the International Application mentioned above. Article 34 PCT governs the International Preliminary Examination Procedure wherein the applicant may amend the claims, the description and the drawings as often as deemed necessary in communication with the examiner at the International Preliminary Examining Authority. The time provided for this interaction between the applicant and the examiner is, as a rule, not less than 6 months and the final date by which the International Preliminary Examination Report must be established, is always given on the first page of any office action in the course of these proceeding.

Table 7 Amendments to the international application

	Amendments to the international application		
	International phase		National phase
Abbreviations: IPEA = International Preliminary Examination Authority IPER = International Preliminary Examination Report	Amendments under PCT Sect. 1 (only if an international search report has been established) PCT Article 19 and Rule 46	Amendments under PCT Sect. 21 (only if an applicant files a demand for international preliminary examination) PCT Article 34 and Rules 53.9 and 66	Amendments upon entering the National Phase PCT Articles 28 and 41 and Rules 52 and 78
Which part(s) of the international application may be amended?	Claims only	Claims, descriptions and drawings	Claims, description and drawings. Different amendments are possible for different designated/elected offices
Where must the amendments be filed?	With the international bureau	With the IPEA	With the designated/elected offices
When must the amendments be filed?	Within 2 months from the date of transmittal of the international search report, or 16 months from the priority date, or before the technical preparations for the international publication have been completed, whichever time limit expires/ event occurs later	May be filed with the demand or during international preliminary examination. They should, however, be filed before the IPEA begins to draw up the IPER	May be filed within 1 month from the date of fulfillment of the requirements for entry into the National Phase. Later time limits may apply – see relevant National Chapter in the <i>PCT Applicant's Guide</i> , Vol. II
In what language must the amendments be filed?	In the language of the international application, if that language is Chinese, English, French, German, Japanese, Russian or Spanish, or in English where the international applications was filed in another language		Where the designated/elected office requires a translation of the international application, the amendments must be in the language of the translation
What is the allowable scope of the amendments?	Amendments must not go beyond the disclosure in the international application as filed. Although this	Amendments must not go beyond the disclosure in the international application as filed. Although this	Amendments must stay behind the disclosure in the international application as filed unless the national

(continued)

Table 7 (Continued)

	Amendments to the international application		
	International phase		National phase
	requirement is not directly enforceable during the international phase, failure to comply may have adverse consequences during international preliminary examination and in the National Phase	requirement is not directly enforceable during the international phase, if any amendment does not comply, the IPEA will make comments in the written opinion and the IPER, and the IPER will be established as if the amendment had not been made	law of the designated/elected State permits them to go beyond that disclosure – see National Chapters in the <i>PCT Applicant's Guide</i> , Vol. II
Where do the amendments have effect?	In all designated/elected offices	In all elected offices	In those designated/elected offices with which they are filed
For what procedures do the amendments serve as a basis?	For examination by the IPEA (unless reversed or superseded) and for examination by the designated/elected Offices in the National Phase (unless superseded by later amendments)	For examination by the IPEA, and, in the National Phase, by elected offices (unless superseded by later amendments)	For examination by the designated/elected offices in the National Phase
May amendments be made more than once?	No	Yes, depending on when the IPER is established. But note that amendments need not be taken into account by the IPEA if they are received after it has begun to draw up a written opinion or the IPER	Depends on the national law
Are the amendments confidential?	They are confidential before international publication. After publication of the international application, amendments published by the International Bureau as part of the Pamphlet are no longer confidential	They are confidential until transmittal of the IPER to the elected Offices. Once the IPER has been transmitted to the elected Offices, any amendments which form part of the annexes to the IPER may be made available by any elected Office whose national law so permits	Depends on national law

4.2 *The Eisper-System, Sect. 2 PCT*

Repetition: The abbreviation EISPE stands for Enhanced International Search and Preliminary Examination. As was explained before, the International Search Authority (ISA) issues a Written Opinion together with the ISR. If the applicant filed a request for International Preliminary Examination – called “Demand” – within either 3 months from the date of transmittal of the ISR and Written Opinion to the applicant or 22 months from the priority date, said Written Opinion from the ISA will become the first written Office Action issued by the International Preliminary Examination Authority (IPEA) in said International Preliminary Examination proceedings. This is the time to interact with the Examiner, i.e. to open a dialog with the Examiner with the aim to remedy the deficiencies mentioned in said first Office Action. One will have to bear in mind, however, that any comments which might have been submitted to the ISA in response to the ISR have not been submitted to the International Preliminary Examination Authority. On the other hand, such comments on the ISR are very rare in case the applicant feels a need to enter International Preliminary Examination proceedings, i.e. if the ISR contains “X”- or “Y”-documents. Truly, there is a possibility to enter the National Phases or Regional Phases without International Preliminary Examination proceedings even in case the ISR contains such allegedly critical documents; however, it is highly advisable in such a situation to “go Sect. 2”, i.e. to request International Preliminary Examination. The overall purpose of doing so is to obtain a positive International Preliminary Examination Report (“IPER” or under the new “EISPE-System: IPRP Sect. 2”). Namely, said IPRP Sect. 2 will be established by the International Preliminary Examining Authority (IPEA) once the applicant had the opportunity to argue on the substance of the invention and to the deficiencies mentioned in the office action issued during International Preliminary Examination. As a rule there will be no second Office Action. The IPRP Sect 2 will be submitted to the elected offices, albeit not before the expiry of 30 months from the priority date, and thus will be available to all national or regional examining authorities once the National or Regional Phases have been entered. The establishment of the IPRP Sect. 2 shall be concluded until 28 months after the priority date.

Summarizing the core difference between the proceedings according to Sect. 1 PCT and Sect. 2 PCT, it should be noted that

Section 1 does *not* provide for any dialog between the applicant and the Examiner and *no* amendments are allowed before the issuance of the IPRP Sect. 1;

and

Section 2 *does* provide for such a dialog and also for amendments, however only *before* the issuance of the IPRP Sect. 2.

4.3 The EURO-PCT-Way: A Valuable Choice

Even more advantages can be achieved by filing a request for International Preliminary Examination if the EPO is elected to be the International Preliminary

PCT

CHAPTER II

DEMAND

under Article 31 of the Patent Cooperation Treaty:
The undersigned requests that the international application specified below be the subject of international preliminary examination according to the Patent Cooperation Treaty.

For International Preliminary Examining Authority use only	
Identification of IPEA	Date of receipt of DEMAND
Box No. I IDENTIFICATION OF THE INTERNATIONAL APPLICATION	
Applicant's or agent's file reference CHOCO 95549	
International application No. PCT/US2006/654321	International filing date (<i>day/month/year</i>) 5 July 2007 (05.07.2007)
(Earliest) Priority date (<i>day/month/year</i>) 21 July 2007 (21.07.2007)	
Title of invention PROCESS FOR FOLDING WRAPPING PAPER FOR CHOCOLATES	
Box No. II APPLICANT(S)	
Name and address: (<i>Family name followed by given name; for a legal entity, full official designation. The address must include postal code and name of country.</i>)	
CANDY WRAP UNLIMITED, INC. 300 Colorado Street Baltimore, Maryland 21201-4307 United States of America	
Telephone No. (301) 876-5432	Facsimile No. (301) 876-5555
Applicant's registration No. with the Office	
State (<i>that is, country</i>) of nationality: US	State (<i>that is, country</i>) of residence: US
Name and address: (<i>Family name followed by given name; for a legal entity, full official designation. The address must include postal code and name of country.</i>)	
JONES, Mary 1600 South Eads Street Arlington, Virginia 22202-2913 United States of America	
State (<i>that is, country</i>) of nationality: US	State (<i>that is, country</i>) of residence: US
<input type="checkbox"/> Further applicants are indicated on a continuation sheet.	

Form PCT/IPEA/401 (first sheet) (April 2007)

See Notes to the demand form

Sheet No. . . .	International application No.
<p>Continuation of Box No. II APPLICANT(S)</p> <p><i>If none of the following sub-boxes is used, this sheet should not be included in the demand.</i></p>	
<p>Name and address: <i>(Family name followed by given name; for a legal entity, full official designation. The address must include postal code and name of country.)</i></p>	
State <i>(that is, country)</i> of nationality:	State <i>(that is, country)</i> of residence:
<p>Name and address: <i>(Family name followed by given name; for a legal entity, full official designation. The address must include postal code and name of country.)</i></p>	
NOT INCLUDED (No further applicants/inventors in this case)	
State <i>(that is, country)</i> of nationality:	State <i>(that is, country)</i> of residence:
<p>Name and address: <i>(Family name followed by given name; for a legal entity, full official designation. The address must include postal code and name of country.)</i></p>	
State <i>(that is, country)</i> of nationality:	State <i>(that is, country)</i> of residence:
<p>Name and address: <i>(Family name followed by given name; for a legal entity, full official designation. The address must include postal code and name of country.)</i></p>	
State <i>(that is, country)</i> of nationality:	State <i>(that is, country)</i> of residence:
<p>Name and address: <i>(Family name followed by given name; for a legal entity, full official designation. The address must include postal code and name of country.)</i></p>	
<p><input type="checkbox"/> Further applicants are indicated on another continuation sheet.</p>	

Sheet No. . . 2

International application No.
PCT/US2006/654321

Box No. III AGENT OR COMMON REPRESENTATIVE; OR ADDRESS FOR CORRESPONDENCE

The following person is agent common representative
 and has been appointed earlier and represents the applicant(s) also for international preliminary examination.
 is hereby appointed and any earlier appointment of (an) agent(s)/common representative is hereby revoked.
 is hereby appointed, specifically for the procedure before the International Preliminary Examining Authority, in addition to the agent(s)/common representative appointed earlier.

Name and address: *(Family name followed by given name; for a legal entity, full official designation. The address must include postal code and name of country.)*

DAVIS, Catherine
2500 Virginia Avenue, N.W.
Washington, D.C. 20037-1902
United States of America

Telephone No.
(202) 557-3054

Facsimile No.
(202) 557-3060

Agent's registration No. with the Office
44,111

Address for correspondence: Mark this check-box where no agent or common representative is/has been appointed and the space above is used instead to indicate a special address to which correspondence should be sent.

Box No. IV BASIS FOR INTERNATIONAL PRELIMINARY EXAMINATION

Statement concerning amendments:*

1. The applicant wishes the international preliminary examination to start on the basis of:
- the description as originally filed
 as amended under Article 34
 - the claims as originally filed
 as amended under Article 19 (together with any accompanying statement)
 as amended under Article 34
 - the drawings as originally filed
 as amended under Article 34
2. The applicant wishes any amendment to the claims under Article 19 to be considered as reversed.
 3. Where the IPEA wishes to start the international preliminary examination at the same time as the international search in accordance with Rule 69.1(b), the applicant requests the IPEA to **postpone** the start of the international preliminary examination until the expiration of the applicable time limit under Rule 69.1(d).
 4. The applicant expressly wishes the international preliminary examination to **start earlier** than at the expiration of the applicable time limit under Rule 54bis.1(a).

* Where no check-box is marked, international preliminary examination will start on the basis of the international application as originally filed or, where a copy of amendments to the claims under Article 19 and/or amendments of the international application under Article 34 are received by the International Preliminary Examining Authority before it has begun to draw up a written opinion or the international preliminary examination report, as so amended.

Language for the purposes of international preliminary examination: English

- which is the language in which the international application was filed.
- which is the language of a translation furnished for the purposes of international search.
- which is the language of publication of the international application.
- which is the language of the translation (to be) furnished for the purposes of international preliminary examination.

Box No. V ELECTION OF STATES

The filing of this demand constitutes the election of all Contracting States which are designated and are bound by Chapter II of the PCT.

Sheet No. ..3

International application No.
PCT/US2006/654321

Box No. VI CHECK LIST		For International Preliminary Examining Authority use only	
The demand is accompanied by the following elements, in the language referred to in Box No. IV, for the purposes of international preliminary examination:		received	not received
1. translation of international application	: sheets	<input type="checkbox"/>	<input type="checkbox"/>
2. amendments under Article 34	: 3 sheets	<input type="checkbox"/>	<input type="checkbox"/>
3. copy (or, where required, translation) of amendments under Article 19	: sheets	<input type="checkbox"/>	<input type="checkbox"/>
4. copy (or, where required, translation) of statement under Article 19	: sheets	<input type="checkbox"/>	<input type="checkbox"/>
5. letter	: 2 sheets	<input type="checkbox"/>	<input type="checkbox"/>
6. other (specify)	: sheets	<input type="checkbox"/>	<input type="checkbox"/>

The demand is also accompanied by the item(s) marked below:

- | | |
|--|---|
| 1. <input checked="" type="checkbox"/> fee calculation sheet | 5. <input type="checkbox"/> statement explaining lack of signature |
| 2. <input type="checkbox"/> original separate power of attorney | 6. <input type="checkbox"/> sequence listing in electronic form |
| 3. <input type="checkbox"/> original general power of attorney | 7. <input type="checkbox"/> tables in electronic form related to a sequence listing |
| 4. <input type="checkbox"/> copy of general power of attorney; reference number, if any: | 8. <input type="checkbox"/> other (specify): |

Box No. VII SIGNATURE OF APPLICANT, AGENT OR COMMON REPRESENTATIVE

Next to each signature, indicate the name of the person signing and the capacity in which the person signs (if such capacity is not obvious from reading the demand).

Catherine Davis
Catherine Davis

For International Preliminary Examining Authority use only

1. Date of actual receipt of DEMAND:	
2. Adjusted date of receipt of demand due to CORRECTIONS under Rule 60.1(b):	
3. <input type="checkbox"/> The date of receipt of the demand is AFTER the expiration of 19 months from the priority date and item 4 or 5, below, does not apply. <input type="checkbox"/> The applicant has been informed accordingly.	6. <input type="checkbox"/> The date of receipt of the demand is AFTER the expiration of the time limit under Rule 54bis.1(a) and item 7 or 8, below, does not apply.
4. <input type="checkbox"/> The date of receipt of the demand is WITHIN the time limit of 19 months from the priority date as extended by virtue of Rule 80.5.	7. <input type="checkbox"/> The date of receipt of the demand is WITHIN the time limit under Rule 54bis.1(a) as extended by virtue of Rule 80.5.
5. <input type="checkbox"/> Although the date of receipt of the demand is after the expiration of 19 months from the priority date, the delay in arrival is EXCUSED pursuant to Rule 82.	8. <input type="checkbox"/> Although the date of receipt of the demand is after the expiration of the time limit under Rule 54bis.1(a), the delay in arrival is EXCUSED pursuant to Rule 82.

For International Bureau use only

Demand received from IPEA on:

CHAPTER II

PCT

FEE CALCULATION SHEET

Annex to the Demand

International application No. PCT/US2006/654321	For International Preliminary Examining Authority use only
Applicant's or agent's file reference CHOCO 95549	Date stamp of the IPEA
Applicant CANDY WRAP UNLIMITED, INC., et al.	
CALCULATION OF PRESCRIBED FEES	
1. Preliminary examination fee	USD 600 <input type="checkbox"/> P
2. Handling fee (<i>Applicants from certain States are entitled to a reduction of 75% of the handling fee. Where the applicant is (or all applicants are) so entitled, the amount to be entered at H is 25% of the handling fee.</i>)	USD 155 <input type="checkbox"/> H
3. Total of prescribed fees Add the amounts entered at P and H and enter total in the TOTAL box	USD 755 <div style="border: 1px solid black; padding: 2px; width: fit-content; margin: 0 auto;">TOTAL</div>
MODE OF PAYMENT <i>(Not all modes of payment may be available at all IPEAs)</i>	
<input checked="" type="checkbox"/> authorization to charge deposit account with the IPEA (see below)	<input type="checkbox"/> cash
<input type="checkbox"/> cheque	<input type="checkbox"/> revenue stamps
<input type="checkbox"/> postal money order	<input type="checkbox"/> coupons
<input type="checkbox"/> bank draft	<input type="checkbox"/> other (specify):
AUTHORIZATION TO CHARGE (OR CREDIT) DEPOSIT ACCOUNT <i>(This mode of payment may not be available at all IPEAs)</i>	
<input checked="" type="checkbox"/> Authorization to charge the total fees indicated above.	IPEA/ <u>US</u>
<input checked="" type="checkbox"/> <i>(This check-box may be marked only if the conditions for deposit accounts of the IPEA so permit)</i> Authorization to charge any deficiency or credit any overpayment in the total fees indicated above.	Deposit Account No.: <u>12-3456</u>
	Date: <u>10 April 2007</u>
	Name: <u>Catherine Davis</u>
	Signature: <u>Catherine Davis</u>

PATENT COOPERATION TREATY

From the
INTERNATIONAL PRELIMINARY EXAMINING AUTHORITY

PCT

WRITTEN OPINION OF THE
INTERNATIONAL PRELIMINARY
EXAMINING AUTHORITY

(PCT Rule 66)

To:		Date of mailing (day/month/year)	
Applicant's or agent's file reference		REPLY DUE within months/days from the above date of mailing	
International application No.	International filing date (day/month/year)	Priority date (day/month/year)	
International Patent Classification (IPC) or both national classification and IPC			
Applicant			

1. The written opinion established by the International Searching Authority:
 is is not
 considered to be a written opinion of the International Preliminary Examining Authority.

2. This _____ (first, etc.) opinion contains indications relating to the following items:

- Box No. I Basis of the opinion
- Box No. II Priority
- Box No. III Non-establishment of opinion with regard to novelty, inventive step and industrial applicability
- Box No. IV Lack of unity of invention
- Box No. V Reasoned statement under Rule 66.2(a)(ii) with regard to novelty, inventive step or industrial applicability; citations and explanations supporting such statement
- Box No. VI Certain documents cited
- Box No. VII Certain defects in the international application
- Box No. VIII Certain observations on the international application

3. The applicant is hereby **invited to reply** to this opinion.

When? See the time limit indicated above. The applicant may, before the expiration of that time limit, request this Authority to grant an extension, see Rule 66.2(c).

How? By submitting a written reply, accompanied, where appropriate, by amendments, according to Rule 66.3.
 For the form and the language of the amendments, see Rules 66.8 and 66.9.

Also For the examiner's obligation to consider amendments and/or arguments, see Rule 66.4bis.
 For an informal communication with the examiner, see Rule 66.6.
 For an additional opportunity to submit amendments, see Rule 66.4.

If no reply is filed, the international preliminary examination report will be established on the basis of this opinion.

4. The final date by which the international preliminary report on patentability (Chapter II of the PCT) must be established according to Rule 69.2 is: _____

Name and mailing address of the IPEA/	Authorized officer
Facsimile No.	Telephone No.

Form PCT/IPEA/408 (cover sheet) (April 2007)

Form 10 Pct-written opinion

Examination Authority (case (a) of Table 8 –“Fee Reductions”). It is highly recommendable to do so because extraordinary good experiences were made going the EURO-PCT-way with International Preliminary Examination at the EPO. Of course, this way is open to Japanese applicants, as is apparent from Form 2, field “Competent International Preliminary Examination Authority” and with the current exclusion of certain technical fields, also to US applicants, as is apparent from Form 3 (again field “Competent International Preliminary Examination Authority”). The Demand must be filed directly with the competent IPEA or, if two or more authorities are competent, with the one chosen by the applicant. This choice can be made on the first page of the Sect. 2 demand by inserting “EP” behind “IPEA/” (see Form 5 to Form 9 “PCT-Demand, page 1–5”). Approximately 3 months after filing said Demand, the elected authority will issue a first office action (“Written Opinion”) in the International Preliminary Examination Proceedings prepared by the regular Examiner who also is notified the date by which the IPER will have to be established.

Moreover, there is a special advantage in using the EPO as International Preliminary Examination Authority: the Examiner processing the application during the International Preliminary Examination is the very same who previously did the search for the ISR and who issued the Written Opinion Sect. 1 and, later on, will deal with the examination at the European Patent Office after the Regional Phase has been entered. This is the result of the introduction of the EPO’s *BEST* (Bringing Examination and Search Together) project. Thus, when the Examiner opens the file again during the Regional Phase, he first looks at what he pointed

Table 8 Fee reductions

Case	(a)	(b)	(c)	(d)	(e)
Fee in USD (US- Dollars) ^a	EPO = ISA EPO = IPEA	EPO = ISA JPO = IPEA	EPO = ISA USPTO = IPEA	JPO = ISA JPO = IPEA	USPTO = ISA USPTO = IPEA
Intern. search fee	1,615.00	1,615.00	1,615.00	600.00	300.00 ^b (1,282.00) ^c
Prelim. exam. Fee	1,595.00	230.00	750.00	230.00	408.00
Exam. fee	745.00 ^d	1,490.00	1,490.00	1,335.00	1,335.00
Suppl. search fee	–	–	–	810,00 ^e	810,00 ^e
Total	3,955.00	3,335.00	3,855.00	2,975.00	2,953.00 (3,835.00)

^a Applied exchange rate: 1 EUR = 1.47 USD; 1 EUR = 158 YEN

^b Payable when a corresponding prior U.S. National application has been filed and the basic filing fee for that application has been paid

^c Regular fee

^d 50% fee reduction included

^e This fee is already reduced by EUR 190.00; the regular fee would have been EUR 1,000.00

out during the International Preliminary Examination Proceedings and, in most cases, the first office action during the Regional Phase merely contains the two sentences.

“The result of the International Preliminary Examination Report (IPER) is made subject of the present Office Action. The applicant is requested to adapt the description to the result of the IPER.”

The applicant may even happen to receive an intention to grant (Communication under Rule 71 (3) EPC) as first office action from the EPO on the basis of the IPER.

It is apparent that it is highly advantageous to elect the EPO as IPEA because the

- Result of the IPER has a direct impact on the European examination procedure covering up to 34 member states
- Examiner of the International Preliminary Examination is the same one during the Regional Phase at the EPO
- EPO provides for several steps to accelerate the proceedings

Thus, the overall advantage of choosing the EPO as IPEA is a cooperative, quick and straight forward prosecution of the International Application.

5 Considerations with Respect to Enforcement After Grant

5.1 How to Prepare Claims Which are Advantageous for Search, Prosecution and Infringement Litigation

5.1.1 General Outline

Under European law, the aspects of Rule 43 EPC (see Sect. 2.3) should be observed concerning the form and content of claims. In particular, the claims shall contain as a rule only one independent claim per category (i.e. one apparatus claim, one method claim and one use claim).

5.1.2 Patent Claims and Possibilities of Amendments

As mentioned above, the extent of protection is defined by the patent claim or claims of a European patent. Since the patent should give an appropriate award to the inventors, it is fully legitimate that the patent claims be worded as broadly as possible. The limits are presented by the prior art on the one hand and the original disclosure on the other hand.

In PCT and European examination procedure, the claims may be modified and amended using the full disclosure of the original case papers, including description, claims and drawings; even such features may be claimed which are only shown in the drawings but not mentioned in the description.

Even though the complete disclosure of the application can be used for amending claims during prosecution, this does not apply to the abstract, even if the abstract is very detailed and clearly comprises further features in addition to the specification. This is ruled by Article 85 EPC.

Moreover, it is established case law that any priority document is *not* a part of the patent application even if it is filed together with the specification. Therefore, no feature may be claimed after filing which is only disclosed in the priority document. Hence, utmost care is to be taken that the specification comprises full disclosure from the very beginning, in particular when several (Japanese) priority applications are combined with each other for filing one PCT or EPC patent application claiming convention priority.

One problem can arise in practice, when the original patent claims as filed are very narrow due to a plurality of features. Many EPO Examiners are reluctant to agree to canceling a feature from the original main claim and hold that this is an inadmissible enlargement under Article 123 EPC. However, the essential provision in such cases is Article 84 EPC:

“The claims shall define the matter for which protection is sought. They shall be clear and concise and be supported by the description.”

Nevertheless, the applicant has the difficulty and time consuming task of convincing the Examiner that the new (broader) patent claim is fully supported by the description and represents a complete solution of the problem underlying the invention.

Therefore, it is highly recommended to start with broad original claims comprising a minimum number of features defining the invention. Advantageous features and further developments should be covered by sub-claims using multiple dependencies.

5.1.3 Structure of Patent Claims

Patent claims can be drafted in the one-part form or the two-part form. In the two-part form, which is preferred by many Examiners and facilitates arguments in favor of the inventive activity, the preamble should comprise those features which are known from the closest prior art. Reference should be made to one document only, not to a mixture of two or more prior-art documents.

It is sufficient to include those features which are of relevance and are essential to the invention. For example, if the invention relates to a photographic camera, but the inventive step relates entirely to the shutter, then it is fully sufficient for the preamble of the claim to read: “A photographic camera including a focal plane shutter”. It is not necessary to include other known features of a photographic camera, such as the lens and the view-finder.

The characterizing portion comprises those features which are not known from the closest prior art and which define the invention concisely and precisely together with the features of the preamble. Of course, only the essential features should be specified in the claims without giving a full list of instructions of how to build the apparatus in question.

Where appropriate, the independent claims can be drafted in the one-part form. This is expedient in some cases. For example, the one-part form is appropriate when the prior-art documents have only some relation to the invention but do not really form the starting point of the invention. When some steps of a method are known from the closest prior art, it is appropriate to draft the main claim in the one-part form giving a clear time sequence of the steps.

Claims in the one-part form are also expedient when the closest prior art is not pre-published but only the content of an older patent application filed prior to the invention in question but not published prior to the filing date of the invention.

Of course, the arrangement and order of features in the preamble or the characterizing portion have no effect on the extent of protection which is only defined by the entirety of the features defining the claim.

5.1.4 Clarity of Claims

The claims should define the invention in a clear and concise manner so that it is readily apparent to everybody what is protected as patentable matter. Only the essential technical features have to be specified which give a clear and complete technical teaching.

Concerning non-technical features, which contribute to a better understanding of the technical teaching and statements of effect and advantages obtained thereby, the practice has become more liberal in the past in the practice of the European Patent Office. Therefore, it is always worth trying to include statements of effect or function to obtain a broad scope of protection – instead of including features with restricting effect.

The EPO Examiners are usually rather lenient in this regard and readily allow non-technical statements for reasons of explanation. Also, statements of function and effect are admissible for defining the invention if a person skilled in the art will readily know which means can be used for carrying out the function without needing inventive activities of his own.

However, indefinite statements should be avoided in the claims, in particular statements like “approximately”, “as small as possible”, “relatively thin, wide or strong”. Such general statements are only admissible when they have a well-recognized meaning in the art, for example “high-frequency” or “thin film technology”.

Also, optional statements like “in particular” or “preferably” are not allowable in the claims. Rather, these expressions should be used in the description for explanation purposes, whereas the technical features can be the subject matter of respective claims.

5.2 Main Claim

A main claim is an independent claim comprising all the technical features essential to the invention without making reference to any other claim. A main claim must comprise all the features which are necessary for solving the object underlying the invention.

On filing and during examination, it is always recommendable to use a minimum number of features in the main claim even though the inventive step may be doubtful. Namely, it is easy to later include features from the sub-claims into the main claim, taking account of the relevant prior art. As outlined above, canceling features in the main claim, however, is very complicated and often considered as “inadmissible enlargement” of the scope under Article 123 EPC.

5.2.1 Independent Claims

In a set of claims comprising several independent claims, the main claim is the first independent claim. All the independent claims must comprise their own invention and, like the main claim, all features which are essential for the solution of the object in question. If a main claim is patentable and another independent claim is not allowable, and the applicant insists on such a further independent claim, the patent application is to be rejected in its entirety.

There are cases where it may not be appropriate to cover the subject matter of an invention in one single independent patent claim of the same category. Assume that the invention relates to a socket and a plug which correspond to each other but can be marketed separately. Then, independent claims should be drafted to cover the respective subject matters.

Of course, the principle of unity of invention must be fulfilled when drafting independent claims. This will be explained later.

5.2.2 Sub-Claims

Sub-claims are dependent claims and comprise all features of another claim, usually in the preamble thereof. Sub-claims may relate to one or several or all of the preceding claims. Also, indirect relations are possible. (For example claim 8 may relate to claim 4 when depending on claim 2.) In such a manner, a tree-like structure of claims can be drafted with multiple dependencies in PCT and European proceedings without any limitation in this regard. This differs *completely* from practice in the U.S.A.

There is no limitation as to the number of claims in Europe. However, a large number of claims may be expensive under the EPC where each claim beyond claim 10 requires one further claim fee. This may result in considerable expenses. Therefore, the claims should be grouped together to the extent and in the most appropriate way possible.

As mentioned above, multiple dependencies should be used as far as possible because it saves claim fees and provides the broadest scope of protection.

If a device can consist of various materials, it is not necessary to list them in single separate sub-claims. Rather, it is possible to draft a sub-claim of the type “A closing mechanism having a sealing cap consisting of a material selected from the

group comprising iron, brass, nickel, aluminum, resin and combinations thereof". Any preferred material could be specified in the description.

Sub-claims may comprise a specific expedient further development of the invention. The features may be known as such but not from the closest prior art defining the preamble of the main claim. Sub-claims may also comprise their own invention, but in such a case it should be carefully checked as to whether the content thereof should be used for drafting an independent claim. Of course, a sub-claim must relate to the same category of claims as the main claim or independent claim to which it relates.

5.3 Categories of Claims

In principle, there are two categories of claims, namely product and substance claims on the one hand and method, process and use claims on the other hand. The differentiation is essential for the extent of protection conferred by the patent and for determining whether the further claims are sub-claims or independent claims with respect to the main claim.

5.4 Several Categories of Claims

In principle, the applicant is free to select several categories of claims. The condition is that the principle of unity of invention be complied with and that the applicant has a legitimate interest for all the claimed categories. The following table comprises a summary of admissible claim categories which may be claimed in combination:

- (a) Product or substance + plus manufacturing process therefore
- (b) Product or substance + manufacturing process therefore + apparatus or means for carrying out the process or method
- (c) Product or substance + manufacturing process + use of the new product or substance
- (d) Substance plus manufacturing process + new intermediate products
- (e) Intermediate product + final product
- (f) Intermediate product + manufacturing process + process for further processing of the intermediate product
- (g) Substance plus analogous process + (pharmaceutical) agent
- (h) Process or method + means for carrying out the process or method
- (i) Process or method + apparatus for carrying out the process or method
- (j) Manufacturing process + use of the products obtained thereby
- (k) Apparatus + product produced by means of the apparatus.

However, under the most current version of rule 43 EPC a European patent application may contain more than one independent claim in the same category (product, process, apparatus or use) *only if* the subject-matter of the application involves one of the following:

- (a) A plurality of inter-related products
- (b) Different uses of a product or apparatus
- (c) Alternative solutions to a particular problem, where it is not appropriate to cover these alternatives by a single claim

It may be taken as a guideline, however, that only one independent claim per category is allowed in one European patent application.

In particular, care should be taken that all the categories of interest are covered by the *original* patent claims. This is the only way to obtain a complete search from the EPO and to avoid problems during prosecution.

5.4.1 Specific Aspects with Respect to Unity of Invention

The *guidelines* for examination in the EPO are consistent with and based upon an agreement between the EPO, the Japanese Patent Office and the U.S. Patent and Trademark Office, concluded in 1988 with a view to harmonizing unity of invention practices in the three Offices.

According to Article 82 EPC, the European application must “relate to one invention only, or to a group of inventions so linked as to form a single general inventive concept”. The second of these alternatives – the single-concept linked group – may give rise to a plurality of independent claims in the same category, but the more usual case is a plurality of independent claims in different categories.

Rule 44 EPC indicates how to determine whether or not the requirement of Article 82 EPC is fulfilled when more than one invention appears to be present. The link between the inventions required by Article 82 EPC must be a technical relationship which finds expression in the claims in terms of the same or corresponding special technical features. The expression “special technical features” means, in any one claim, *the particular technical feature or features* that define a contribution that the claimed invention considered as a whole makes over the prior art.

Once the special technical features of each invention have been identified, one must determine whether or not there is a technical relationship between the inventions and, furthermore, whether or not this relationship involves these special technical features. Moreover, it is not necessary that the special technical features in each invention be the same. Rule 44 EPC makes clear that the required relationship may be found between corresponding technical features.

An example of this correspondence can be the following: in one claim, the special technical feature which provides resilience or elasticity can be a metal spring, whereas in another claim, the special technical feature which provides the resilience or elasticity can be a block of rubber.

Another example is an electrical bridge-rectifier circuit where it may be necessary to include separate independent claims relating to single-phase and poly-phase arrangements incorporating such circuits since the number of circuits needed per phase is different in the two arrangements.

A further example is a transmitter and a receiver which are separate items which can be marketed separately. Such a pair of receiver and transmitter can be linked, for example, by the common inventive concept of controlling and maintaining the operation frequency.

In particular, the following combinations or groups of independent claims are acceptable under the EPC as one group of inventions in the same application:

- (i) In addition to an independent claim for a given product, an independent claim for a process specially adapted for the manufacture of the product, and an independent claim for a use of the product; or
- (ii) In addition to an independent claim for a given process, an independent claim for an apparatus or means specifically designed for carrying out the process; or
- (iii) In addition to an independent claim for a given product, an independent claim for a process specially adapted for the manufacture of the product, and an independent claim for an apparatus or means specifically designed for carrying out the process

While a single set of such independent claims according to any one of the combinations (i), (ii) or (iii) above is always permissible, an Examiner is not obliged to accept a plurality of such sets. Rather, the general provision of Rule 44 EPC applies. In other words, if two independent claims for a process specially adapted for the manufacture of the product are claimed, then they must also be linked by special technical features or a general inventive concept.

The requirement that the process be specially adapted for the manufacture of the product is fulfilled if the claimed process inherently results in the claimed product. On the other hand, it is clearly not sufficient for the wording “specially adapted” to be used in the claim itself because such wording does not necessarily imply that a single general inventive concept is really present.

The requirement that the apparatus or means be specifically designed for carrying out the process is fulfilled if the apparatus or means is suitable for carrying out the process and if there is a technical relationship as defined in Rule 44 EPC between the claimed apparatus or means and the claimed process. It is not sufficient for unity that the apparatus or means is merely capable of being used in carrying out the process. On the other hand, the expression “specifically designed” does not exclude that the apparatus or means could also be used for carrying out another process, or that the process could also be carried out using an alternative apparatus or means.

Unity of invention should be considered to be present in the context of intermediate and final products where:

- (i) the intermediate and final products have the same essential structural element, i.e. their basic chemical structures are the same or, their chemical structures are

technically closely interrelated, the intermediate incorporating an essential structural element into the final product, and

- (ii) The intermediate and final products are technically interrelated, which means that the final product is manufactured directly from the intermediate or is separated from it by a small number of intermediates all containing the same essential structural element

Unity of invention may also be present between intermediate and final products of which the structures are not known – for example, as between an intermediate having a known structure and a final product with unknown structure, or as between an intermediate of unknown structure and a final product of known structure. In such cases, there should be sufficient evidence to lead one to conclude that the intermediate and final products are technically closely interrelated as, for example, when the intermediate contains the same essential element as the final product or incorporates an essential element into the final product.

Different intermediate products used in different processes for the preparation of the final product may be claimed provided that they have the same essential structural element. The intermediate and final products should not be separated, in the process leading from one to the other, by an intermediate which is not new. Where different intermediates for different structural parts of the final product are claimed, unity should not be regarded as being present between the intermediates. If the intermediate and final products are families of compounds, each intermediate compound should correspond to a compound claimed in the family of the final products. However, some of the final products may have no corresponding compound in the family of the intermediate products so that the two families need not be absolutely congruent.

The mere fact that, besides the ability to be used to produce final products, the intermediates also exhibit other possible effects or activities should not prejudice unity of invention.

Alternative forms of an invention may be claimed either in a plurality of independent claims, or in a single claim. In the latter case, the presence of the two alternatives as independent forms may not be immediately apparent. In either case, however, the same criteria should be applied in deciding whether or not there is unity of invention, and lack of unity of invention may then also exist within a single claim.

Where a single claim defines (chemical or non-chemical) alternatives, i.e. a so-called “Markush grouping”, unity of invention should be considered to be present when the alternatives are of a similar nature. Namely, it is in line with European law that a claim, whether independent or dependent, can refer to alternatives provided those alternatives are of a similar nature and can fairly be substituted one for another and provided also that the number and presentation of alternatives in a single claim does not make the claim obscure or difficult to construe.

Lack of unity may be directly evident a priori, in other words before considering the claims in relation to the prior art, or may only become apparent a posteriori, namely after taking the prior art into consideration. The former case is present when

the independent claims clearly follow different technical directions and principles. The latter case may arise when prior art is revealed during examination which leads to limitation of the independent claims where the common concept is not inventive any more. Then, two or more independent claims may be left, but even if they are patentable, they are not linked any more by “special technical features”.

No objection on account of lack of unity is justified in respect of a dependent claim and the claim from which it depends, even when the dependent claim contains an independent invention. For example, suppose claim 1 claims a turbine rotor blade shaped in a specified manner, while claim 2 relates to claim 1 and is characterized in that it is produced from an alloy Z. Then, no objection under Article 82 EPC arises either because alloy Z was new and its composition was not obvious and thus the alloy itself already contains the essential features of an independent patentable invention, or because although alloy Z was not new, but its application in respect of turbine rotor blades was not obvious, and thus represents an independent invention in conjunction with turbine rotor blades.

5.4.2 Example

The amendments of claims in connection with the aspect of unity will be explained by means of an example defined by the following claims. Assume that the object underlying the invention is “to provide a cooling chamber for accommodating various goods and which is to be protected against undesirable temperature losses”. The claims may read as follows:

1. A cooling chamber, comprising
 - (a) Storing means for accommodating goods
 - (b) Cooling means for cooling the interior of the chamber
 - (c) Control means for controlling the operation of cooling means, and
 - (d) Closing means adapted for closing the chamber which is accessible from outside,
characterized in that
 - (e) The closing means comprise a sliding door
 - (f) The sliding door is provided with automatically operating return means adapted for returning it into its closing position
2. The cooling chamber according to claim 1,
characterized in that
 - (g) The return means comprise pusher means operated by spring means pre-stressing the sliding door towards its closing position
3. The cooling chamber according to claim 1,
characterized in that

(h) The return means comprise a cable operated by a weight adapted to draw the sliding door into its closing position

4. The cooling chamber according to claim 1,
characterized in that

(i) The return means comprise a linear motor adapted to operate on the door by energizing electric coil means thereof moving the sliding door into its closing position.

5. The cooling chamber according to any of claims 1–4,
characterized in that

(j) The return means include actuation means operated by means of a timer and/or temperature sensing means in order to maintain the temperature under a predetermined maximum room temperature in the cooling chamber.

The main claim is in the two-part form reflecting a prior-art document comprising features (a)–(d).

Of course, such a set of claims is readily acceptable both under the PCT and European patent law under the aspect of unity. Please note that the aspects of novelty and inventive activity are completely neglected in this context.

Now, assume that *further* prior art is revealed which anticipates not only features (a)–(d) in the preamble of claim 1, but also features (e) and (f) of the characterizing portion in claim 1.

Then, three new independent claims could be drafted comprising

- (i) Features (a)–(f) plus feature g) (= new claim 1)
- (ii) Features (a)–(f) plus feature h) (= new claim 2); and
- (iii) Features (a)–(f) plus feature i) (= new claim 3)

Original claim 5 could follow as new claim 4.

1. A cooling chamber, comprising

- (a) Storing means for accommodating goods
- (b) Cooling means for cooling the interior of the chamber
- (c) Control means for controlling the operation of cooling means, and
- (d) Closing means adapted for closing the chamber which is accessible from outside,

wherein

- (e) The closing means comprise a sliding door
- (f) The sliding door is provided with automatically operating return means adapted for returning it into its closing position

characterized in that

- (g) The returning means comprise pusher means operated by spring means pre-stressing the sliding door towards its closing position

2. A cooling chamber, comprising
 - (a) Storing means for accommodating goods
 - (b) Cooling means for cooling the interior of the chamber
 - (c) Control means for controlling the operation of cooling means, and
 - (d) Closing means adapted for closing the chamber which is accessible from outsidewherein
 - (e) The closing means comprise a sliding door
 - (f) The sliding door is provided with automatically operating return means adapted for returning it into its closing positioncharacterized in that
 - (g) The return means comprise a cable operated by a weight adapted to draw the sliding door into its closing position
3. A cooling chamber comprising
 - (a) Storing means for accommodating goods
 - (b) Cooling means for cooling the interior of the chamber
 - (c) Control means for controlling the operation of cooling means, and
 - (d) Closing means adapted for closing the chamber which is accessible from outsidewherein
 - (e) The closing means comprise a sliding door
 - (f) The sliding door is provided with automatically operating return means adapted for returning it into its closing positioncharacterized in that
 - (g) The return means comprise a linear motor adapted to operate on the door by energizing electric coil means thereof moving the sliding door into its closing position
4. The cooling chamber according to any of claims 1–3,
characterized in that
 - (h) The return means include actuation means operated by means of a timer and/or temperature sensing means in order to maintain the temperature under a predetermined maximum room temperature in the cooling chamber.

Under European law, and also under the PCT, such a set of (new) claims is lacking unity because the three independent claims are not linked by a general inventive concept, in other words special technical features any more. Namely, the original link provided by features (e) and (f) is already part of the prior art and cannot form the general inventive concept any more.

In such a case, the applicant has to decide which invention (independent claim) is further prosecuted in the application; the other alternatives can be made the subject matter of divisional applications. The other possibility is to find another single general inventive concept in the disclosure of the invention which is capable of uniting them.

Now, with respect to the Example, there is a fall-back position represented by original claim 5 comprising feature (k). Namely, when original claim 1 is anticipated by some prior art, features (a)–(f) would form the preamble of a new main claim while feature (k) could form the characterizing portion of the new main claim. Then, original claims 2–4 could readily follow as sub-claims defining further developments of the subject matter.

1. A cooling chamber, comprising
 - (a) Storing means for accommodating goods
 - (b) Cooling means for cooling the interior of the chamber
 - (c) Control means for controlling the operation of cooling means, and
 - (d) Closing means adapted for closing the chamber which is accessible from outside,

wherein

 - (e) The closing means comprise a sliding door
 - (f) The sliding door is provided with automatically operating return means adapted for returning it into its closing position

characterized in that

 - (g) The return means include actuation means operated by means of a timer and/or temperature sensing means in order to maintain the temperature under a predetermined maximum room temperature in the cooling chamber
2. The cooling chamber according to claim 1,

characterized in that

 - (h) The return means comprise pusher means operated by spring means pre-stressing the sliding door towards its closing position.
3. The cooling chamber according to claim 1,

characterized in that

 - (i) The return means comprise a cable operated by a weight adapted to draw the sliding door into its closing position
4. The cooling chamber according to claim 1,

characterized in that

 - (j) The return means comprise a linear motor adapted to operate on the door by energizing electric coil means thereof moving the sliding door into its closing position

On the other hand, it is possible to draft three independent claims, namely

- (i) Features (a)–(f), plus features (k) and (g) (= new claim 1)
- (ii) Features (a)–(f), plus features (k) and (h) (= new claim 2); and
- (iii) Features (a)–(f), plus features (k) and (i) (= new claim 3)

1. A cooling chamber, comprising

- (a) Storing means for accommodating goods
- (b) Cooling means for cooling the interior of the chamber
- (c) Control means for controlling the operation of cooling means, and
- (d) Closing means adapted for closing the chamber which is accessible from outside,

wherein

- (e) The closing means comprise a sliding door
- (f) The sliding door is provided with automatically operating return means adapted for returning it into its closing position

characterized in that

- (g) The return means include actuation means operated by means of a timer and/or temperature sensing means in order to maintain the temperature under a predetermined maximum room-temperature in the cooling chamber
- (h) The return means comprise pusher means operated by spring means pre-stressing the sliding door towards its closing position

2. A cooling chamber, comprising

- (a) Storing means for accommodating goods
- (b) Cooling means for cooling the interior of the chamber
- (c) Control means for controlling the operation of cooling means, and
- (d) Closing means adapted for closing the chamber which is accessible from outside,

wherein

- (e) The closing means comprise a sliding door
- (f) The sliding door is provided with automatically operating return means adapted for returning it into its closing position

characterized in that

- (g) The return means include actuation means operated by means of a timer and/or temperature sensing means in order to maintain the temperature under a predetermined maximum room temperature in the cooling chamber
- (h) The return means comprise a cable operated by weight adapted to draw the sliding door into its closing position.

3. A cooling chamber, comprising
- (a) Storing means for accommodating goods
 - (b) Cooling means for cooling the interior of the chamber
 - (c) Control means for controlling the operation of cooling means, and
 - (d) Closing means adapted for closing the chamber which is accessible from outside,

wherein

- (e) The closing means comprise a sliding door
- (f) The sliding door is provided with automatically operating return means adapted for returning it into its closing position

characterized in that

- (g) The return means include actuation means operated by means of a timer and/or temperature sensing means in order to maintain the temperature under a predetermined maximum room temperature in the cooling chamber
- (h) The return means comprise a linear motor adapted to operate on the door by energizing electric coil means thereof moving the sliding door into its closing position

Such a set of claims is clearly admissible under the aspect of unity of invention, both under the PCT and European patent law. The reason is that in each case feature (k) forms the “special technical feature” required under Rule 44 EPC, and of course these sets of revised claims also solve the specific problem underlying the invention as outlined above.

The alternatives according to the third amended set of claims may appear somewhat limited – but sometimes there is no other choice in view of pertinent prior art.

5.5 Patent Infringement Litigation – Problems and Points to Consider

5.5.1 Extent of Protection

When a European patent has been granted, the most important component is the patent claims.

Under the EPC, the protection is defined in Article 69 EPC:

Article 69 EPC

Extent of Protection

- (1) The extent of the protection conferred by a patent or a patent application shall be determined by the terms of the claims. Nevertheless, the description and the drawings shall be used to interpret the claims
-

Statute 3 – Article 69 EPC

Due to European harmonization, the same or similar wording is used in national patent law of the respective member states.

Since interpretation of claims may be difficult on the one hand and on the other hand should be carried out in a similar manner throughout Europe, the so called “Protocol on the Interpretation of Article 69 EPC” was adopted at the Munich Diplomatic Conference for the setting up of a European System for the Grant of Patents on October 5, 1973, and revised by the Act revising the EPC of 29th November 2000, as set out below:

Article 1 – General Principles

“Article 69 EPC should not be interpreted as meaning that the extent of the protection conferred by a European patent is to be understood as that defined by the strict, literal meaning of the wording used in the claims, the description and the drawings being employed *only for the purpose of resolving an ambiguity* found in the claims. Nor should it be taken to mean that the claims serve only as a guideline and that the actual protection conferred may extend to what, from a consideration of the description and drawings by a person skilled in the art, the patent proprietor has contemplated. On the contrary, it is to be interpreted as defining a position between these extremes which combines a fair protection for the patent proprietor with a reasonable degree of legal certainty for third parties.”

Article 2 – Equivalents

“For the purpose of determining the extent of protection conferred by a European patent, due account shall be taken of any element which is equivalent to an element specified in the claims.”

Accordingly, legal and commercial disadvantages for the patentee can only be avoided, if utmost care was taken when drafting claims during prosecution.

Experience has shown that claims with the broadest scope of protection are those which comprise a minimum number of features and/or claims of the so-called “means plus function” type. The reason is that such claims can cover a huge number of embodiments and provide a strong position to the patentee.

5.5.2 Excursion: Situation in the U.S.A.

We note that case law in the U.S.A., in particular the decision of the Court of Appeals in re. Donaldson has changed the situation in the United States considerably with respect to the scope of protection granted by U.S. patents. Namely, the U.S. Patent Act is very detailed as to the drafting of claims and the scope thereof, see for example 35 U.S.C. Section 112 Paragraph 6, quoted in the pertinent case law and reading as follows:

“An element in a claim for a combination may be expressed as a means or step for performing a specified function without the recital of structure, material or acts in support thereof, and such claim shall be construed to cover the corresponding structures, materials, or acts described in the specification and equivalents thereof.”

However, such a restrictive rule does not exist in European patent law, neither in the EPC itself nor in the rules relating thereto.

5.5.3 Situation in Europe

The decisive provision is found in Article 84 EPC concerning the claims and giving only a general indication as follows:

“The claims shall define the matter for which protection is sought. They shall be clear and concise and be supported by the description.”

According to the European harmonization among the member states to the EPC, similar provisions can be found in the national Patent Acts.

Further aspects can be found in Rule 43 EPC relating to the form and content of the claims. Of course, the claims must be drafted in terms of the “technical features of the invention”, and the claims should not contain any statements relating, for example, to commercial advantages or other non-technical matters. However, statements of purpose or effect or function are allowed if they assist in defining the invention. Also, it is not necessary that every feature be expressed in terms of a structural limitation. Functional features may readily be included provided that a person skilled in the art would have no difficulty in providing some means of performing this function without exercising inventive skill. Hence, claims to the use of the invention in the sense of the technical application thereof are allowable.

From the above explanations, it should be clear that, in principle, patent claims written in the “means plus function format” are well acceptable under the EPC, in particular when their functional statement contributes to the clarity of the feature to be defined thereby. There are no rules in the EPC to readily reject such claims. Also, they are not limited in scope in the sense as provided in the U.S. patent law. Of course, it is to be decided case by case as to whether the “means plus function format” is really appropriate and acceptable to the respective Examiner in charge.

5.5.4 Problems of Broad Claims

One problem which arises with claims giving only a general outline and/or comprising the “means plus function format” resides in that the scope thereof is very broad. For example, “locking means with safety function” may cover a huge variety of embodiments. Therefore, a broad patent claim comprising a “means plus function format” will attract a huge number of prior-art references because various conventional locking means with safety function may already exist. Even if the specific means according to prior-art documents may differ completely from the specific embodiments described in a new patent specification, they can readily anticipate the broad feature “locking means with safety function”. In such a situation, the applicant cannot but restrict the patent claim to the specific embodiments in order to escape from such prior art.

However, once a patent has been granted comprising features in the “means plus function format”, they give the full broad protection without being limited down to the specific embodiments as described in the patent specification (unlike the situation in the U.S.A.). When the applicant has made an invention which comprises a

generalized teaching going beyond specific embodiments, the full scope of protection is awarded to such an applicant and patentee.

This is due to the fact that interpretation of European claims is ruled by Article 69 EPC and the Protocol of the Interpretation of Article 69 of the European Convention, as quoted above. In particular, emphasis is put on the fact that according to the Protocol the... “description and drawings being employed only for the purpose of resolving an ambiguity found in the claims”.

Please bear in mind that the quoted Protocol is an integral part of the EPC pursuant to Article 164 EPC and is directly applicable law in the contracting states to the EPC.

5.5.5 Re-Examination of Granted European Patents

Once a European patent has been granted, the EPO Examiners can only be involved with one aspect of such claims, namely when opposition proceedings and/or opposition appeal proceedings are started. Then, they have to re-examine the granted claims as to patentability when considering additional prior art cited by an opponent. However, the EPO Examiners are never involved in patent litigation matters after grant of a European patent. The reason is that any such patent litigations are handled by the national Civil Courts in the respective contracting states where an infringement may take place.

In other words, during re-examination under opposition or appeal, the EPO Examiners compare a granted claim comprising a “means plus function format” in its broad meaning with every prior-art document cited by an opponent. Then, it may readily happen that such a broad claim must be restricted in opposition or appeal due to prior art which is pertinent to such a broad coverage as defined by the general wording of the claim.

When it comes to patent litigation, however, the national Civil Courts are bound by Article 69 EPC and corresponding provisions in the national patent laws as well as the Protocol quoted above.

5.5.6 Scope of Protection

By tradition, the scope of protection awarded by German Civil Courts based upon granted patents is rather wide, no matter whether national German patents or German patents based upon granted European patents are concerned.

Before the EPC came into force, we had a so-called trinity of protection awarded by a patent, namely (a) scope of protection awarded by the literal wording of the claims, (b) scope of protection awarded by the claims and the equivalents thereof, and (c) the scope of protection awarded by the so-called general inventive concept which could be derived from the teaching of the patent.

Due to European harmonization, the “general inventive concept” was abandoned in Germany, but the scope of protection is still very broad under the doctrine of equivalence. Hence, it is well established German practice that claims comprising

a “means plus function format” are understood as claims giving a broad scope of protection because any such means are covered thereby without being limited by specific details in the description of preferred embodiments.

5.5.7 Situation in Other European Countries

According to information from British colleagues, the situation is quite similar in the United Kingdom. In other words, they also contribute a broad scope of protection to such a claim comprising a “means plus function format” and also apply the doctrine of equivalence. Sometimes, the scope of equivalence in the United Kingdom seems to be somewhat smaller than in Germany, at least according to estimation of our British colleagues. But it is difficult to give evidence in this regard because it is a rare case that you have both identical patents and identical infringements in both countries which are decided in Court so that they would result in directly comparable Court Decisions.

It goes without saying that a similar situation applies to France where they also apply the broad scope of protection awarded by a claim comprising a “means plus function format”. This is not surprising in view of the provisions provided by Article 69 EPC and the Protocol relating thereto.

With respect to France, however, one particularity should be considered. According to long-lasting practice in France, patent applications are not examined as to patentability before grant. Even though a search report is established, the applicant is free to modify the claims in the light of prior art cited in the search report, or to obtain registration of the patent on the basis of the original case papers.

Therefore, it is well established practice in France that in litigation matters handled by the Civil Courts, the defendant presents two arguments, namely

- (a) He does not infringe the patent in question, and
- (b) The patent is not valid in view of the prior art

Accordingly, it is common practice that in one and the same patent litigation proceedings, the Civil Courts in France decide both on the question of nullity and the question of infringement.

This practice also applies to granted European patents having protection in France where a defendant may readily attack the granted patent because of nullity reasons presenting prior art which may be the same as at the EPO or also some additional prior art. Then, it may turn out in practice in such French patent litigation proceedings that the French Civil Court awards a limited scope of protection in such litigation proceedings. However, the reason is not based upon the “means plus function format” of the claim, rather such narrow protection is due to the fact that in view of the (additional) prior art cited against the patent in question, the judges hold that the scope of protection is to be reduced.

6 Summary

Patent claims granted under the EPC provide a broad scope of protection, provided that they have carefully been drafted with a strong main claim comprising a minimum number of features, whereas various embodiments are covered by the features in sub-claims connected by the use of multiple dependencies.

In infringement situations, the competitor can be attacked on the basis of the main claim and suitable sub-claims which are combined with each other to cover the infringing subject. In nullity situations, the patentee has various fall-back positions by supplementing an attacked main claim by one or more sub-claims in order to survive.

Since the doctrine of equivalence is applied throughout Europe by the member states to the EPC, the patentee has a strong position after grant of a patent.

Trademark Protection in Germany and Europe

E. Popp

1 The Profession of Patent Attorneys in Germany

Until the year 1900, professional advice and representation in matters of patents, trademarks and registered designs was not regulated.

This shortcoming was removed by the Patent Attorney Law of May 21, 1900. Patent Attorneys could only now be persons who, after a university technical education, had passed a legal examination. The title “Patent Attorney” was legally protected.

In 1933 the Patent Attorney Law was adapted to the general regulation for Attorneys at Law. A Patent Bar Association was established, which obtained the authority to supervise Patent Attorneys. Also, the Patent Bar Association obtained competence in cases of first instance on discipline matters.

Moreover, Patent Attorneys, along with Attorneys at Law obtained a monopoly of professional representation in intellectual property matters. Patent Attorneys got the right to plead before courts (right of hearing and participation).

On September 7, 1966 the Patent Attorneys Law was replaced by a Patent Attorney Act in which the areas of authority of the Patent attorney were clearly defined and since then the training of the patent attorney has also been regulated. In supplement to this, the Federal Minister for Justice has issued a “Training and Examination Rule”.

Par. 1 of the Patent Attorney Act defines the position of the Patent attorney in the administration of justice and, within the framework of his activities, declares him to be an independent organ of the administration of justice.

The position of the Attorney as an independent organ of justice has its roots in the history of the status of attorney in general. It follows the development from state-dependency to free advocacy in the modern legal systems.

The term “organ” is assigned to persons having functions within the society. The function of the patent attorney as “organ” is his legal administrative activity together with State authorities. From this arises his responsibility to properly implement the law.

1. His professional activity must be guided exclusively by the needs for aid and security of the person seeking justice who is overburdened by complex legal systems and not by his financial interests.
2. The patent attorney must be fully committed to the purpose of law. This includes for example the duty of the patent attorney with his qualifications and objectivity to strive for a fair decision of the Patent Office, the Patent Court or the Civil Courts.

The patent attorney should not be an “accomplice of the State”. Rather, Par. 1 of the Patent Attorney Act clearly states that the patent attorney is an “independent” organ in the administration of justice. The independence requires that he not be partial to the State or his client.

Certainly, the activity of the patent attorney, just like the Attorney at Law, is integrated into the judicial system. However, he does not have executive power.

The patent attorney is not independent of his client in the sense that he may act on his own voluntary discretion. He must fulfill his legal administrative duties, independently assess the factual matter and respond, based on his own assessment.

3. The activity of the patent attorney is restricted by the scope of activities set down under Par. 1 of the Patent Attorney Act. Those activities are defined in Par. 3 and 4 of the Patent Attorney Act. Accordingly, the patent attorney has the professional duty
 - To advise and represent parties in matters of attainment, maintenance, defense and enforcement of a patent, of a protective certificate supplementing a patent (pharmaceuticals and plant protective agents), of a utility model, of a protected topography, of a trademark or of another sign protected by the Trademark Law, e.g., company name, etc. or of a protective right for plant varieties
 - To represent parties before the Patent and Trademark Office and the Patent Court in matters for which these authorities are competent
 - To represent parties before the Federal Supreme Court in proceedings relating to nullity suits or withdrawal of a patent or of a supplementary protective certificate, or pertaining to granting of a compulsory license
 - To represent parties before the Federal Authority for plant varieties in matters relating to plant variety protection
 - To advise and represent parties on questions which relate to an Intellectual Property right, a design patent, a data processing program, an unprotected invention or other technical development, a protective right for plant varieties or an unprotected plant cultivation or to advise on legal questions directly related to such matters and
 - To participate and plead before the competent court in litigation deriving from the activities of the patent attorney

As already mentioned, with the Patent Attorney Law of 1933, the patent attorney obtained a monopoly for professional representation in matters of Intellectual

Property protection. This monopoly is guaranteed by the so-called “Legal Consultation Law”, which also protects legal advice by

- Attorneys at Law
- Public Notaries
- Certified Accountants
- Tax Advisers

According to Par. 2 of the Patent Attorney Act, the patent attorney exercises a so-called “free profession” and not a “trade”. The essential features of the free profession are:

- The lack of profit motive, i.e., the maximisation of profit should not dominate, but rather assistance for those seeking justice. Naturally, the patent attorney like any other legal adviser must operate his business in a profitable way, in order to maintain independence from the State as well as from clients, i.e., if necessary, also to be able to refuse a client
- Prohibition of offering services for a success-related fee (commission)
- Binding of the professional law firm to its proprietors or members
- The provision of personal services
- Independence of the market

Despite the independence under Par. 1 of the Patent Attorney Act and the exercise of a free profession according to Par. 2, the patent attorney as an “organ of legal administration” is naturally obligated to ensure the function of the legal system. Therefore, the patent attorney, like any other legal adviser is obligated to ensure that his clients behave in accordance with the law. This influence of the attorney on the client is assumed by the state; therefore, the attorney also enjoys a certain amount of “trust” when presenting the factual case.

To this extent the patent attorney is obligated to the “truth”, but naturally also has a “loyalty” with respect to what his client entrusted to him.

If there is a conflict here, the patent attorney must refuse his services. In concrete terms this may be when a client requires the patent attorney to present an un-truth, e.g., to make statements known to be incorrect in trademark matters with respect to use of the Trademark.

Naturally, the patent attorney, as an “organ of legal administration” is not under any obligation to betray his client. To this extent the patent attorney, like an Attorney at Law or notary, is protected by law. He need not make any statements relating to information entrusted to him by his client, but is subject to a secrecy obligation. He can only be relieved of this obligation by his client. In order that the interaction between the law and best representation of the client (trust) can function, the patent attorney is bound by a so-called Professional Act.

This regulation foresees the following basic duties of a patent attorney:

- Conscientiousness (in exercise of the profession)
- Independence (both of State and society, i.e., independence of the client)

- Secrecy (betrayal of party is a punishable offence)
- Objectivity (in disagreements with Authorities, Courts and Opponents, the personal emotions of the clients must be kept out of the discussion)
- Prohibition of opposing interests (e.g., opposition to a trademark, the registration of which the patent attorney has previously pursued)
- Administering assets (moneys of the client must be held and used for the intended purpose)
- Duty of access (office accessible to the public)
- Restricted advertising (advertising allowed, if objective; no comparative advertisements, such as “I am better than Attorney X and in addition even cheaper!”)
- Professional behaviour (only objective disagreement with other colleagues; avoidance of personal insults)
- Duty of training

The supervision of patent attorneys is carried out by the Patent Bar already mentioned. It is an institution of public law, with its seat in Munich.

The Patent Bar Association has the duty to protect and further the interests of the profession and to ensure that its members observe their professional responsibilities.

The agents of the Patent Bar Association are:

- The Executive Board
- The Assembly of the Bar

The President of the German Patent Office exercises State supervision of the Patent Bar Association. This supervision is restricted to seeing that the law and the constitution regulating the organization and administration of the Patent Bar Association are observed.

The duties of the Executive Board of the Patent Bar Association are:

- To advise and instruct the members, i.e., the individual patent attorneys, in questions of professional duties
- When requested to mediate in disagreements between members of the Bar
- When requested, to mediate in disagreements between the members of the Bar and their clients
- To monitor fulfillment of the duties placed on the patent attorneys, and to exercise disciplinary action (Council for the first instance disciplinary matters)
- To provide yearly accounts of the assets of the Bar
- To issue expert opinions, as required by the Federal Ministry of Justice, a Court or an administrative authority, in particular the German Patent Office
- To participate in the training of candidates to become a patent attorney
- To nominate Patent Attorneys as members of the examining commission

Before which Authorities and Courts is and may the patent attorney be active?

<p>In all application proceedings, Trademark cancellation proceedings (absolute bars) and Utility Model cancellation proceedings before the German Patent- and Trademark Office</p> <p>Federal Patent Court (Appeal Level)</p> <p>Federal Supreme Court (legal appeal, participatory)</p>	<p>In Nullity and Compulsory License proceedings before the</p> <p>Federal Patent Court</p> <p>Federal Supreme Court (appeal level)</p> <p>In EU Trademark matters before the</p> <p>OHIM</p> <p>Court of First Instance of European Court of Justice (participatory)</p>	<p>In infringement proceedings (participatory) before the</p> <p>District Court</p> <p>District Appeals Court</p> <p>Federal Supreme Court (legal appeal)</p> <p>In European Patent matters before the European Patent Office (First and second instance)</p>
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Lastly, it should be pointed out that according to the patent attorney Act, Patent Attorneys may undertake the common practice of their profession with:

- Attorneys at Law
- Tax Advisers
- Certified Accountants
- Attorneys at Law who are also Notaries

Due to his experience and training as well as his daily business, the patent attorney is certainly the first person to contact when seeking counsel in the field of Intellectual Property. This applies in particular to persons from abroad, as the patent attorney is professionally qualified to handle international matters for example under the Paris Convention, the Strasbourg Patent Convention, the European Patent Convention, the Community Trademark Convention or the Madrid Trademark Agreement. Accordingly, the patent attorney as a rule has adequate language skills and a number of contacts at home and abroad. The patent attorney can carry out and evaluate searches as a basis for a patent application, TM application, etc.

In an infringement suit, the patent attorney can appoint a suitable Attorney at Law in the respective jurisdiction who has the experience in Intellectual Property. In this respect it should also be pointed out that it is a legal requirement that foreigners, e.g., patent or trademark applicants from abroad, appoint a representative from within

Germany. As such, either a patent attorney or an Attorney at law may be appointed, because only these two professions have the corresponding monopoly under the law.

2 Trademark Protection in Germany

2.1 A New Product – Five Types of Protection

The illustrated activities of a patent attorney show that he is the competent person to consult on the question of which type of protection is available for a new product. This will now be demonstrated with the example of a *new telephone*.

2.1.1 Patent Protection

A company develops a new telephone able to identify and execute acoustic signals as commands, e.g., dialing certain pre-stored numbers, redialing a number, etc. The hardware elements of the memory and identification module of the acoustic receiver are patentable because they provide a completely new technical solution of high inventive quality.



Patent Application

2.1.2 Utility Model

The telephone receiver can be disassembled and transformed into a headphone. This has the advantage that the operator can speak freely and at the same time has his hands free to take notes. One can sort through papers; notes on the conversation can even be typed into a computer. The inventive step in solving this problem, which is somewhat smaller than for patent protection, would suggest the filing of a utility model.



Utility Model Application

2.1.3 Design Protection

The external appearance of the telephone is different from other devices. It has a distinctive character and is therefore suited for the filing of a design patent at the German Patent and Trademark Office. The design is then protected against imitations. However, novelty and distinctiveness of the design, the basic requirements of this protection right, are only examined during an infringement suit.



Design Application

2.1.4 Trademark Protection

The telephone is sold under the product name Pronton®. The product name is legally protected only when it is entered into the Trademark register at the German Patent and Trademark Office, assuming that no older claims on the product name are in force. If not registered, protection can arise if the mark attains “market recognition”. This will be addressed further hereinafter. Also, a service mark could be obtained by the company which services such telephone systems.



Trademark Application

2.1.5 Copyright Protection

The telephone is accompanied by a user manual containing instructions, graphics and tables. The manual is copyright protected. The right need not be registered in Germany, since it automatically belongs to the creator under the law.



Copyright Application

2.2 *The Trademark Law in Germany*

The new Trademark Act, in force since January 1, 1995, was conceived as a uniform regulation for all commercially used signs. Thus, it includes not only the product and service marks obtained by registration or by intensive use, but also the trade designations previously protected by unfair competition laws. This includes trade names (companies) and titles such as newspaper titles, titles of theatre productions, television shows, etc. Also included are appellations of geographic origin.

2.3 Signs Protectable as Trademarks

According to Par. 3 of the German Trademark Act, all of the following signs can be protected:

- Words including personal names
- Designs
- Letters
- Numerals
- Acoustic signs
- Three-dimensional configurations, including
 - The shape or packaging of a product
- Other dressings including
 - Colors and color combinations
 - Taste
 - Smells
 - Animated pictures

The above signs are naturally only protected if they are able to be represented graphically and distinguish the goods or services of one enterprise from those of another. These prerequisites will be discussed in more detail later.

In the following, some examples of protected signs are shown as publication copies:

2.3.1 Words

A Single Word Mark



13.8.71. adidas Sports Shoe Factory Adi Dassler KG,
8522 Herzogenaurach Am Bahnhof.

Business Activity: Manufacture and selling of sportswear and sports apparatus, selling of promotional articles.

Goods: Shoes, insoles, spikes and studs for sports shoes, spike key, stud key, shoe laces, shoe care products and equipment, shoe boxes, bags for shoe boxes; clothing (including mechanical knitted and hand knitted), stockings, gloves, bags and suitcases

Personal Names

3

1 060 901*

S 39116/3 Wz

JIL SANDER

16.7.83. Heide-Marie Sander (Pseudonym: Jil Sander),
2000 Hamburg 13, Milchstr. 8-9.

Business Activity: Manufacture and sales of all type of goods, trading concern, manufacture of designs and advertising for third parties.

Goods/Services: Soaps, perfumery, essential oils, cosmetics, hair lotions; dentifrices; deodorants; manicure sets, shaving apparatus; optical instruments, in particular spectacles, sun glasses, correction spectacles, contact lenses, spectacle frames, lens glass; spectacle cases; electrical curling tongs; massage apparatus; hair drying apparatus; jewellery; real and imitation jewellery, also from different materials; precious stones; time pieces; goods made of leather or of leather imitations, namely handbags and other cases not adapted to the product as they are intended to contain as well as small articles of leather, in particular purses, pocket wallets, key cases; hides and animal skins; trunks and travelling bags; travel and handbags; umbrellas, parasols and walking-sticks; appliances and apparatus for the care of the body and beauty care namely combs and sponges, brushes, tooth brushes, mouth rinses; textiles; bed and table covers; household linen, in particular hand towels, face cloths, bath towels, makeup removal tissues, bed linen; clothing, in particular men's and ladies outer garments of textiles, leather, fur and other materials, bath robes, hats, gloves as well as boots, shoes and slippers, belts; laces and embroidery, ribbons and braids; buttons, hooks and eyes, needles; artificial flowers, clothing accessories, in particular brooches (without precious metal and no imitation jewellery), needles (without precious metal), clasps; product design and packaging for third parties. GK. 3, 5, 8, 9, 10, 11, 14, 18, 21, 24, 25, 26, 42.

14.4.84

14.3.84

30.4.84

Advertising Slogans

16a

785777

P 11982

good.....
better.....
Paulaner

22.12.62. Paulaner-Salvator-Thomasbräu-A.G.,
 Munich 9, Regerstr. 28.

Business Activity: Beer brewery.
Goods: Beer. GK. 16a. Int. Cl. 32.

63/1763

18.3.64

64/1110

Signs comprising several words can be put together to form a slogan. Protection is then possible when the slogan includes the actual product mark, here “Paulaner”.

2.3.2 Letters and Numerals

9

1 090 536

A 40306/9 Wz

AEG

20.8.85. AEG Corporation, 6000 Frankfurt 70, Theodor-Stern-Kai 1.

Business Activity: Manufacture and sales of all types of goods, in particular of electronic, mechanical engineering and chemical products and equipment, import and export business, building and repair, planning and information/advice, training, renting and leasing.

Goods/services: Combustible elements for nuclear reactors, chemical products for technical purposes, namely fixing agents, synthetic resins, adhesives and hardening substances; tempering, welding and solder preparations; partially processed precious and non-precious metals and their alloys; current collectors – super Structures for electric driven land vehicles; small iron mongery, Locksmith and smithy work. Cabling and finishing; carrying out calculations for third parties; carrying out developments, tests and research assignments; technical advice and expert opinions; leasing of data processing equipment. GK. 9, 1, 6, 7, 8, 10, 11, 12, 14, 16, 17, 19, 20, 21, 35, 37, 41, 42.

31.12.85

21.4.86

31.5.86

[511] 41	[210] 39627364.5	[111] 396 27 364
42		
[220] 21.06.1996	[151] 25.10.1996	[450] 30.01.1997

[540] **MTV**

[732] **Kahle, Regina**, Friedrich-List-Str. 2/1,70736, Fellbach, Germany

[750] Patent Attorneys Jackisch-Kohl & Kohl, Stuttgarter Str. 115, 70469 Stuttgart

[740] Jackisch-Kohl and Associates, Stuttgarter Str. 115, 70469 Stuttgart

[510] catering for and entertainment of guests in gastronomic sectors.

34	206680	E 11265
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4711

1/3 1915. Eau de Cologne and Perfume Factory “Glockengasse No. 4711”
gegenüber der Pferdepost von Ferd. Mühlens, Cologne. 28/10 1915.

Business Activity: Perfume and soap factory.

Goods: Eau de Cologne, hair lotions and toilet water, perfumery, cosmetic products, hair, beard, mouth, dental and skin care products, pomades, powder, sachets, smelling salts, shaving, toilet and glycerine soaps.- Descr. (GK 34, 2)

15/1409		52/234
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25	2 074 951*	L 37963/25 Wz
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501

21.12.93. Levi Strauss & Co., a Corporation under the law of the State of Delaware, San Francisco, California (USA).
Representative: Droste, attorney, 20354 Hamburg.

Goods/Services: Jeans. GK. 25.

30.7.94	12.8.94	30.9.94
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2.3.3 Designs, Emblems, E. G.

39

2 008 220*

M 70792/39 Wz



25.9.91. Mercedes-Benz AG, 7000 Stuttgart 60, Mercedesstr. 136.

Business Activity: Development, manufacture and sales of vehicles, motors and other technical drives, equipment, machines and other technical equipment, other industrial products, technical systems and methods on the aforementioned areas; trade with all raw materials and processing materials, unfinished and finished products and goods, those that have connection with articles commonly used in these business sectors; Providing services in the area of the afore-mentioned activities.

Goods/Services: Repairs or maintenance of motor vehicles, in particular utility vehicles, their tractors, trailers, flat-bed trailers and/or interchangeable open body trailers; mobile services (breakdown services) and towing of motor vehicles.

2.3.4 Combined Words and Designs, E. G.

3

894 504*

W 23569



29.10.71. Wella AG, 6100 Darmstadt, Berliner Allee 65.

Business Activity: Manufacture and sales of chemical and electronic products such as the operation of a general trade, import and export business.

Goods: Bleaching preparations and other substances for laundry use; cleaning, polishing, scouring and abrasive preparations; soaps; perfumery, essential oils, cosmetics, hair lotions; dentifrices; substances for cleaning, shoe laces; buttons; press studs, hooks and eyes, pins; artificial flowers. GK. 3, 5, 11, 21, 26.

72/1480

21.6.72

72/1857

2.3.5 Melodies and Tunes

e.g., recognized melody of a TV program (jingle) or the sound of a “HARLEY DAVIDSON” or the like

It should be noted that to file such acoustic signs, they must be represented *graphically*, whether this is in the form of

- Written music

HARIBO



or in the form of

- A sonogram, i.e., graphic representation of acoustic vibrations

The same holds for odor marks, taste marks (chromatographical representations), touch marks (surface representations) or animated picture marks. The principal

consideration is that these marks must be graphically represented. However, this is not a legal matter, but only a technical problem to be solved.

2.3.6 Three-Dimensional Marks

This concerns especially the *shape of an article*, e.g., soap in a specific form, e.g., in the shape of an animal or the fragrance of an Eau de Cologne.

[511] 3

[220] **09.02.1995**

[540]

[210] 39505775.2

[151] 22.08.1996

[111] **395 05 775**

[450] 30.11.1996



[732] **Calvin Klein Cosmetic Corp. Wilmington, US**

[750] Attorney Association: Boehmert & Boehmert, Hollerallee 32, 28209 Bremen

[740] BOEHMERT & BOEHMERT, Hollerallee 32, 28209 Bremen

[510] 03: Eau de Cologne

[544] three dimensional marks

[511] 3 [210] 39409236.8 [111] 394 09 236
 09, 14, 16, 18, 25
 [220] 01.01.1995 [151] 20.08.1996 [450] 30.11.1996
 [540]



[732] **Hohe-Modelle Maria Hohe GmbH & Co.** Bahnhofsteig 8
 Pegnitz, Germany
 [750] Patent attorneys Dipl.-Ing. E. Tergau, Dipl.-Ing. D. Tergau,
 Mögelder Hauptstr 51, 90482 Nuremberg
 [740] E. Tergau and Colleagues, Mögelder Hauptstr 51,
 90482 Nuremberg
 [510] Soaps, Perfumes, essential oils, cosmetics, hair lotions a
 dentifrices; children's outer garments, paper, cardboard and goods
 made from these materials (as far as contained in Class 16);
 stationery; jeweller products, jewellery; watches and timing
 instruments; leather and leather imitations as well as goods
 made thereof (as far as contained in Class 18), in particular
 rucksack kitbags and bags made from textile materials; cases
 made for spectacles.

Remark: This is a publication under the new German Trademark Act as in force since January 1, 1995.

Codes		
[511] Classes	[210] Appl. no.	[111] Reg. no.
[220] Appl. Date	[151] Reg. date	[450] Publ. date of reg.
[540] Representation of the mark		
[732] Applicant/owner		
[750] Agents		
[740] Address of service		
[510] Specification of goods/services		

In such cases, the shape should represent a “distinguishing” *addition* to the goods. For this reason, a shape determined by the goods itself is excluded from protection, e.g., the illustration of a common book for the protection of books is excluded as a trademark.

The above bottle represents a very peculiar packaging for mouth wash.

3

943 653*

L 20926



2.3.76. LINGNER + FISCHER GMBH, 7580 Bühl, Hermann-Str. 7.

Business Activity: Manufacture and sales of chemical/pharmaceutical, cosmetic and chemical/technical products.

Goods: medications, chemical products for healing purposes and health care, pharmaceutical drugs, preparations for body and beauty care, soaps, bleaching preparations and other substances for laundry use; starches and starching products for cosmetic purposes, all mentioned goods in fluid form. GK. 3, 5.

76/1195

22.4.76

76/1436

The following is an International Registration (“IR-Marke”) showing the famous “Michelin man” as example for advertising figures or emblems which may be protected as trademark.

(151) 01.12.1980 *≅ registration date* *registration no ≅* 457 818

(180) 01.12.2010 *← period of protection*

(171) 10

(732)	COMPAGNIE GÉNÉRALE			← <i>applicant/owner</i>
	DES	ÉTABLISSEMENTS		MICHELIN
	MICHELIN		&	-
	Société	en	commandite	par
				Cie,
				actions

*12, cours Sablon,
F-63040 CLERMONT-FERRAND Cedex (FR)*

(811) FR

(842) Société en commandite par actions FRANCE

(740) Monsieur

Robert

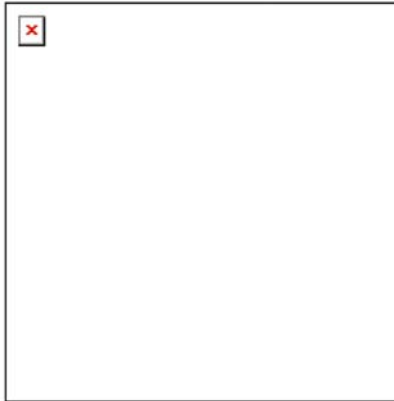
HIEBEL

MICHELIN & CIE

Service SGD/LG/PI-LAD

F-63040 CLERMONT-FERRAND CEDEX 01 (FR)

(540)



specification
of
goods/services
 ↓

(531) 02.01

- (511) 09 Appareils et instruments électriques (y compris la T.S.F.), optiques, de mesure, de signalisation.
 11 Appareils et instruments d'éclairage.
 14 Produits d'horlogerie et articles de bijouterie, joaillerie, orfèvrerie en vrai et en faux.
 16 Articles en papier, imprimés, matières adhésives, papeterie, cartes à jouer, stylos, porte-crayon.
 20 Articles décoratifs en matières plastiques.
 21 Articles de verrerie, porcelaine, faïence et récipients portatifs pour le ménage et la cuisine.

- 24 Articles textiles décoratifs et, particulièrement, fanions, écussons.
 25 Blousons, anoraks, maillots à manches courtes, cravates, casquettes.
 26 Épingles de cravate, boutons de manchette, fleurs artificielles; insignes.
 28 Jeux, jouets, articles de sport.
 34 Briquets, cendriers, allumettes.

FR, 26.06.1980, 4492

← prior home registration

FR, 26.06.1980, 1 150 623

FR, 26.06.1980, 150 623

AL, AM, AT, AZ, BA, BG, BX, BY, CH, CU, CZ, DE, DZ, EG, ES, HR, HU, IT, KG, KP, KZ, LI, LR, MA, MC, MD, MK, MN, PT, RO, RU, SD, SI, SK, SM, TJ, UA, UZ, VN, YU ← designated states

2.3.7 Colors and Color Combinations

Few would disagree that we are influenced by colors, that we associate colors with specific phenomena and that they arouse our emotions. That is why consistent use of a color or a combination of colors is utilized for profiling and marketing of companies, products and services. But even so, is it possible to claim the sole right to a color? Is it perhaps even possible to register a color as a trademark?

Yellow, red and orange are warm colors, while blue, green and violet are cold ones. Warm colors are seen as stimulating and cold ones as calming. While evidence for these assertions is often sketchy, they are used in such widely differing disciplines as architecture, therapeutic treatments and naturally in marketing. Whether we believe the assertions or not, we can agree that colors affect people differently. In some situations, color identifies function, just as words or pictures do. Still, in comparison with words, color is more flexible since it can be used in different ways, while a word or picture always looks the same. With this in mind, shouldn't it be possible to assert the identification and role of color in support of claiming the sole right to that identification?

For some years now there has existed a theoretical possibility of registering colors, as well as fragrances and sounds as Trademarks in Germany. The trademark must, as already mentioned, be able to be depicted graphically and the basic requirement of distinctness applies to colors as well. The color should be able to distinguish one company's goods and services from another's.

Seen from the perspective of traditional Trademark law, it is difficult to imagine that a color has distinctness. A color is not normally used to delineate a company's goods and services, and all colors must be available for everyone to use in marketing. Nor is it intended that anyone should be able to monopolize a color for certain goods and services and block all use of that special color in connection with other goods and services. However, there might exist a justifiable interest in being able to reserve the sole right to the use of a special color as an identification for a limited number of goods and services.

The requirement for distinctness must include the restriction that the color to be used for these goods and services is not used publicly, such as yellow and red for traffic signs. Nor may it have a practical or functional meaning, such as the bright yellow used for alpine rescue services. But in situations where the registration of the color would not restrict other uses, and where there does not already exist a justifiable need for others to use that exact color, it should be possible to register the color.

Still, it isn't that easy to register a color. The possibility is still relatively new and lacks precedents in German practice. However, interest for these somewhat unusual trademarks is growing, which should create such precedents in future. The description of the goods and services will probably have to be very specific and descriptions which are too general or comprehensive will hardly be approved. In addition, the color must be carefully indicated, using such systems as the RAL-German standard-system. Finally, it is probable that at least in the foreseeable future evidence of trademark establishment must be presented. One of the best ways to prove

that a trademark has distinctness is to demonstrate that it is actually perceived as a trademark, e.g., the color violet for chocolate (violet wrapping) from Jacobs Suchard.

Even if the sole right to the color cannot be registered as a trademark, it is important to continue to use the color as a trademark consistently. If possible, action should be taken against any infringement of the right developed in this way.

There exist a number of cases in other countries where a color has been protected. France has granted trademark status to a traditional pink color long used for baking powder and a specific shade of green-gold color registered in the United States for the clothes press pads used in dry-cleaning.

In conclusion it is worth noting that a combination of colors has a higher degree of distinctness and is probably easier both to get registered and to defend as an established trademark.

GERMAN TELECOM



2.3.8 Applications of Geographical Origin

Concerning applications of geographical origin which also fall under the new Trademark Act, only the following brief explanation is being given. Under Par. 126, Section 1 Trademark Act, such appellations include the names of:

- Places
- Regions
- Countries

Such signs can include words and/or pictures.

- The “Eifel Tower” indicates for example “Paris”
- The word “Champagne” characterizes a sparkling wine from the region of “Champagne” (France)
- “Made in Thailand” indicates a product manufactured in Thailand

In contrast to trademarks and other trade names, the appellations of geographical origin do not distinguish goods or services of one enterprise from another. For example, “WALLIS” is not registrable for cosmetic products because it is a well known Region in Switzerland. There have to be at last negative connotations in the target country kept in mind, which can be seen from for example “IRISH MIST”, i.e., “Irish Manure” in German, or “NIX”, i.e., “Nothing” in German.

Class 33: The IRISH MIST Liqueur



Class 3: The NIX detergent



Basically, they may be used by all enterprises located in the geographic region in question. Thus such appellations incorporate a collective good will to which all enterprises concerned are commonly entitled.

On the other hand, so called *pseudo-designations of origin* suggest a geographic region. However, in reality they have no geographic origin or have lost their original geographic meaning through improper use, e.g., “Wienerschnitzel” for a special type of breaded veal, or “Pilsener” or “Pils” for a special type of beer (Note: “Pilsener-Urquell” is a protected designation). These pseudo-designations are not protected by the Trademark Act.

2.4 Acquiring Trademark Protection

According to Par. 4 of the Trademark Act, protection arises through:

- The *registration* of a sign as a trademark in the register at the German Patent Office
- The commercial use of the sign in the market, provided that the sign has acquired prominence as a trademark within the relevant trade circles, or
- The notoriety of a mark, i.e., it has become *well known* in the sense of Article 6 of the Paris Convention.

1. Concerning protection of a trademark by registration, details will be provided later.
2. When trademark protection is asserted based on use and corresponding prominence of a mark in Germany, it is necessary to prove a sufficient degree of reputation.

If the mark is distinctive per se, no reputation is required. For less distinctive marks, extensive use is required, whereby the origin should be apparent.

3. In Germany, the “notoriety” of a mark does not require that the mark also be used in Germany. In practice, this is difficult to imagine. However, use in Germany is not a prerequisite for “attaining notoriety”.

A rather extreme example relates to the former East Germany (DDR). The mark “NIVEA” was a very well known mark for skin cream. In the former East Germany, it doubtless had notoriety, although the product was not available there.

To give you a feeling for the relationship between a mark being well known and acquiring protection, I refer to the following illustration:

4. Relationship between Notoriety and Protection

	Degree of Reputation				
Type of Mark	No Reputation Required	Well Known Mark > 33 %	Established Mark > 50 %	Notorious Mark > 60 %	Famous Mark > 80 %
Registered Mark	Start of Protection by Registration	Protection against Dilution or Exploitation			
Non-Registered Mark			Start of Protection	Protection against Dilution or Exploitation	
Mark not used and not registered in Germany				Start of Protection	Protection against Dilution or Exploitation

The proof of sufficient prominence of a mark can be provided on the basis of a demographic poll. For example, for a mark relating to clothing, kitchen appliances or dishes, about 2,000 should be questioned who are representative of the entire population according to age, sex, occupation and income. The costs for such a poll range from € 10,000 to € 20,000.

Instead of demographic polls, other types of evidence are recognized, such as

- Information from professional organizations
- Information from Chambers of Commerce
- Proven expenses for advertising
- Sales figures compared to the competition

2.5 *Protection Obtained by Registration*

The normal and usually simpler method of obtaining trademark protection is by application at the German Patent Office and by registration in the Register. The requirements include an official application and payment of the prescribed office fees.

A separate application at the German Patent Office is required for each mark to be protected. The minimal requirements for the application according to Par. 32, Section 2 Trademark Act are:

1. The name and address of the applicant
2. A reproduction of the trademark
3. A list of the goods and/or services

In addition, the application should state in which *form* the mark is to be registered, i.e., as a

- Word mark
- Design mark
- Three-dimensional mark
- Acoustic mark, etc.

For design marks, combined word and design marks as well as three-dimensional marks, a two-dimensional reproduction should be provided. For the three-dimensional marks, views from six different angles are allowed.

A mark can be registered for goods and/or services of several classes according to the Nice Classification Convention of June 15, 1957. It is not necessary as in some other countries to file a separate application for each class of goods or services.

If the applicant wishes to claim priority of an earlier foreign application, this can be done within 2 months after the German filing date (Par. 34 Section 3 Trademark Act). The priority period is 6 months according to Article 4 of the Paris Convention. Instead of the Paris Convention, it is also possible that a reciprocity agreement exists with the country of the applicant.

Finally, it should be noted that an applicant without residency or a place of business in Germany requires a local representative namely, a German patent attorney or lawyer. He represents the case before the German Patent Office or the Federal Patent Court (Par. 96 Trademark Act).

According to Par. 35 Trademark Act it is also possible to claim a trade fair priority. In such a case, it must be an officially recognized domestic or international exhibition, at which the goods or services are offered under the trademark in question. This priority by means of a trade fair can be claimed by domestic or foreign applicants. The priority period is 6 months.

2.6 Procedures for Registering a Trademark

2.6.1 Examination of the Filing Requirements

Upon filing, it is examined whether the above mentioned formalities for application of a mark are fulfilled. If the Patent Office finds deficiencies and if these are not remedied within a term set by the Patent Office, the application is considered not to have been filed. When the deficiencies are subsequently overcome, the application date is shifted to the day the deficiencies have been remedied.

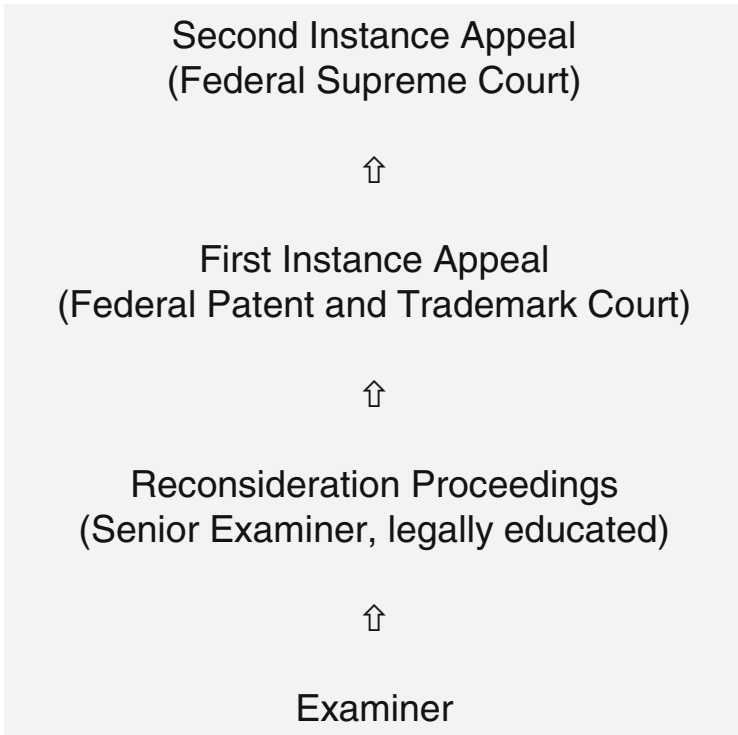
2.6.2 Examination by the Patent Office with Respect to Absolute Bars to Protection

The substantive law (Par. 8 Trademark Act) provides for examination of the mark with respect to absolute bars to protection. Excluded from protection are:

- Signs which cannot be graphically represented (Par. 3 Trademark Act)
- Signs which are devoid of any distinctive character, i.e., are not suited to distinguish the goods and/or services of one enterprise from those of another (Par. 3, Section 1 Trademark Act)
- Signs that should belong to the public domain, i.e., signs which in the market could denote the kind, composition, quantity, intended purpose, value, geographic origin, date of production of the goods or of providing services or other characteristics of the goods or services
- Signs which have become customary everyday language or which have become common usage in established practice in trade for the goods or services (Par. 8, Section 2, nos. 2 and 3 Trademark Act)
- National emblems, national coats of arms, inspection signs or signs of quality
- Marks offending against public order or decency and morality
- Signs which would obviously confuse the public as to the type, composition or geographical origin of the goods or services
- Signs whose use would obviously be prohibited in view of public interest
- Signs which would collide with a well known foreign mark

If the German Patent Office finds such bars to protection with respect to all or part of the goods or services, the application is either partially or completely rejected. The applicant can respond with a first instance appeal if the decision came from the “First Examiner”. In addition, a second instance appeal is possible if the decision resulted from a “first instance examiner”. The second appeal is handled by the Federal Patent Court. If the Federal Patent Court finds that basic legal issues require clarification, it may allow the legal appeal (revision) which goes to the Federal Supreme Court.

Repetitive: The sequence of instances



It should be mentioned that the applicant may limit the list of goods and/or services in examination proceedings, however, he cannot extend the list. In addition, nothing can be amended with respect to the presentation of the trademark itself.

Example: The filed trademark comprises a part which includes the Thai national emblem. The objection to this cannot be remedied in that the applicant requests that this part of the trademark be removed.

The same holds if a filed trademark contains a part including a well known sign, e.g., the auto mark FORD. Amending the mark by removing the FORD emblem is also not possible.

When all of the objections of the German Patent Office or of the Federal Patent Court are overcome, possibly by limiting the goods and/or services, the trademark is registered in the Register with all relevant data. The applicant receives a registration document and a detailed certificate with all essential data of the registration.

An illustration of the trademark with all of the data (also later amendments such as name changes, assignments, legal actions, etc.) are published in the *Trademark Gazette* published by the Patent Office.



20.10.1997

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3. Jahrgang

ISSN 0947-787X

MARKENBLATT

Veröffentlichungen auf Grund des Markengesetzes
Herausgegeben vom Deutschen Patentamt

INHALTSVERZEICHNIS

TEIL 1	Eingetragene Marken	12988
	a) gegen die Widerspruch erhoben werden kann	12989
	b) gegen die kein Widerspruch mehr erhoben werden kann	13198
TEIL 2	Widersprüche	13200
TEIL 3	Teilungen, Rechtsübergänge, Teilweise Rechtsübergänge	13209
TEIL 4	Verlängerungen	13212
TEIL 5	Löschungen, Teillöschungen	13219
TEIL 6	Dingliche Rechte, Zwangsvollstreckung, Konkursverfahren	13227
TEIL 7	Geographische Angaben/Ursprungsbezeichnungen (VO (EWG) Nr. 2081/92)	-
TEIL 8	Änderungen, Berichtigungen	13228
	Früher bekanntgemachte Zeichen, die nicht eingetragen wurden	13241
	Vergleichshinweise	13242
	Nach Registernummern geordnetes Verzeichnis	13248
	International registrierte Marken	-



10.6.89. Privatbrauerei Dortmunder Kronen GmbH & Co., 4600 Dortmund I, Märkische Str. 85.
Geschäftsbetrieb: Brauerei.

Waren/Dienstleistungen: Exportbier. – Farbig. GK.
32.
15.9.89 1.2.90 15.3.90

The publication allows owners of older trademarks to examine whether the newly entered marks collide with existing marks or company names. Such watches are conducted by Patent Attorneys or patent information firms, such as COMPUMARK or the like.

2.6.3 Relative Bars to Protection

Starting from the publication date in the Trademark Gazette a 3 month Opposition term begins. Within this term, the owners of older marks of prior time rank or owners of prior applications may file Opposition.

The owners of other older signs such as

- Companies
- Company logos
- Work titles, such as book titles, magazine titles, film titles, music titles, theatre titles, etc.
- Design rights in respect of graphic signs
- Copyrights are required to file a cancellation action before a civil court and/or to prohibit the use of such a mark before a civil court with a request for injunction.

In all of the above cases, it is examined whether

- (a) A similarity exists between the goods or services of the older sign with those of the opposed trademark, and
- (b) A similarity between the compared signs exists with respect to:
 - Phonetics
 - Conceptual content, or
 - Graphic representation including character type for word marks

Prior copyrights go beyond the similarity of goods or services. Again, in opposition cases the possibility of a first instance appeal exists against the decision of a “first examiner”. A second instance appeal is possible against a decision of the first instance examiner. Further, if basic legal issues are in question a legal appeal (revision) is possible.

The course of the legal procedures in Opposition proceedings are the same as those in prosecution proceedings, except that in Opposition, two parties are present.

An extended protection exists for owners of well known or notorious trademarks.

Such marks can have validity beyond the scope of similar goods and/or services. The protection scope is broader, the more notorious the mark is. The enforcement of such marks is made before a civil court because an Opposition at the German Patent Office, as mentioned above, can only be based on an older trademark application or trademark registration.

The owner of a trademark well known in Germany can prohibit the use by third parties of an identical or similar sign even for non-similar goods/services in so far as the use of the sign in the market *exploits* or *diminishes* the value of the well known mark.

Example: “Dimple” is a well known mark for Whisky of higher quality. The owner of that mark could prohibit the use of it for “men’s cosmetics”.

An even further extended protection is enjoyed by “notorious” trademarks. Notorious marks enjoy absolute protection in all branches of the market. Notorious marks in Germany are, e.g.,

CAMEL	(originally only cigarettes)
4711	(cologne for men)
Mercedes	(Mercedes Star)

Repetitive: well known and notorious Trademark

Well known or notorious Trademarks

validity beyond the scope of similar goods and/or services

Example: CAMEL (originally only cigarettes)
 4711 (cologne for men)
 Mercedes (Mercedes Star)

Well known in Germany

prohibition of use for identical or similar signs even for non-similar goods/services

Example: „Dimple“ prohibited for „men´s cosmetics“

2.6.4 Acquisition and Loss of Trademarks

- (a) The owner of a trademark can prolong the protection of a registered mark (for all or part of the registered goods/services) repeatedly in 10 year periods by payment of the extension fee. The extension of a mark is published in the Trademark Gazette.
- (b) According to Par. 49 Trademark Act, the registration of a trademark can be cancelled upon request by any third party. This is the case if the trademark is *not used* in an uninterrupted time period of 5 years according to Par. 26 Trademark Act from the date of registration or from the conclusion of an Opposition proceeding. The request by the third party can be made at the German Patent Office (Par. 53 Trademark Act). If the owner of the trademark does not react to the request within 2 months from the date of service of the cancellation request, the trademark registration is being cancelled. If the owner opposes the request, the third party is required to take further legal action, i.e., a cancellation action before a civil court.

The objection of lack of use can also be made in an opposition proceeding before the German Patent Office or before the Federal Patent Court. This also

applies to the mark asserted in opposition in so far as this mark has been registered longer than 5 years. If the opponent in such a case cannot substantiate sufficient use, the opposition is dismissed without any examination of the matter of confusion.

With respect to the requirement of use, Par. 26 Trademark Act was mentioned. This provision specifies the necessary form of the use of a trademark such that its validity can be maintained. Basically, the registered trademark must be used in the form in which it is *registered*, i.e., with all of the word, graphics, form or acoustic elements of which it consists, without leaving out or adding anything.

Repetitive: Renewal and Cancellation of registered Trademarks

Renewal of registered Trademark

for all or part of the registered goods/services repeatedly in a ten years period by payment of extension fee

Cancellation upon request by a third party

if not used in an uninterrupted period of five years (Grace period : First five years after registration)

but :

No Office Action requesting proof of use

Modifications by the owner can only be allowed if they do not alter the distinctive character of the trademark. Whether this is true or not depends on the particular market, i.e., on the particular case. In the following two cases, it was found that a valid use of the registered mark had taken place.

1. The Appeals Court in Munich had to make a decision in the following case. The trademark "ALISEO" was registered for hair dryers as shown below

Registered



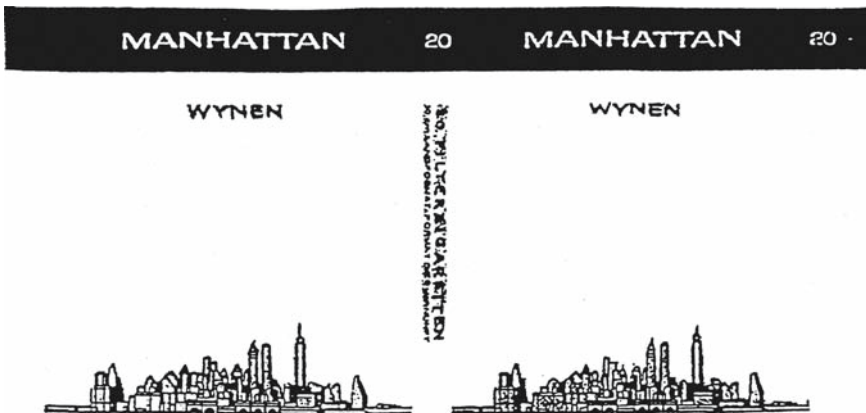
The trademark was, however, only used as a word mark according to
Actually Used



The usage of this trademark is different from the registered form only in details, thus protected. Moreover, the trademark was only used on business papers and not on hair driers.

The Appeal Court held in its judgment of January 25, 1996 that there was a use preserving rights in spite of the modified form of use. The distinctive character of the trademark was the word “ALISEO”, the picture component was only an addition. The change of the type face from a wavelike form into normal type was an insignificant modification. Also, the fact that the trademark was only used on business papers had no negative effects. According to the new trademark law, the described use is sufficient.



2. There is a similar decision of the Federal Patents Court. The trademark “Manhattan” was registered for cigarettes. However, the trademark was only used in the form shown below,



that is to say together with the word “wynen” as well as the skyline of a city with high-rise buildings.

Also, in this case the Federal Patents Court confirmed a use preserving rights in its decision of February 1, 1995. These two examples show that a use preserving rights is taken for granted if the trademark as such is clearly recognisable.

Repetitive: Registered and actually used Trademarks

		Registered
		Actually used
<p>The usage of this Trademark is different from the registered form, thus unprotected</p>		

Before the new German Trademark Act entered into force on January 1, 1995, the case law was much more restricted. For example, the use of the registered single word ARTREXFORTE, but in the modified form with a hyphen, i.e., ARTREX-FORTE was not found to be sufficient to preserve the trademark right. The above two examples show that the previous restrictive interpretation is no longer applicable. The newer case law accounts for the rapid transition in marketing and the corresponding representations of registered trademarks.

Example: A trademark registered for “pharmaceutical products” is used for “bandages”. Although bandages and pharmaceutical products have similarity, the use does not support the registered goods “pharmaceutical products”.

The scope of use must be serious, even a small volume of sales can be sufficient if it is commercially relevant. Unsubstantiated business transactions are not sufficient to preserve the right of a trademark.

2.7 *Miscellaneous*

2.7.1 Searches for Older Signs

The extensive effort required in developing a new trademark can be worthless if a conflict exists with an already existing trademark. Since the German Patent Office only investigates absolute bars to protection in the registration proceedings, a conflicting older trademark or an older sign, e.g., an older company name, only becomes apparent in an opposition before the German Patent Office or the Federal Patents Court or in a cancellation action before a civil court. To avoid this possibility and in particular also to avoid infringing a registered mark, an older title, e.g., a newspaper or film title, or an older company name, it is indispensable and legally advisable (negligence and possibility liability damages by infringement) to investigate whether an identical or similar trademark, company or title already exists for the same or similar goods and/or services. The corresponding investigation is made by a search in the relevant documents including:

- Trademark register of the German Patent Office
- International trademark register (WIPO)
- For design marks, the German and International design registers
- The register of the Community Trademarks
- Registered and used titles (books, films, computer software)
- Register of companies

To carry out such searches, a Patent Attorney, specialized lawyer or a specialized firm, e.g., COMPUMARK should be commissioned. However, the latter is not authorized to provide advice as to the relevance of the signs located. For this a patent attorney or attorney at law must be consulted.

Based on experience, a search of registered marks, company designations, copyrights, etc. is highly recommended before filing a trademark application in Germany or a Community Trademark application at the OHIM or in particular before using such a mark. Unpleasant complications at a later date can be avoided in this way. Such complications could include:

- Worthless filing costs
- Useless expense for advertising, packaging, or the like
- Possible confiscation and destruction of the products having an infringing sign
- Stressful search for a replacement trademark to fulfill an order and the delivery of products to Germany
- Attorney and court costs
- Contract penalties due to non-fulfillment of a delivery contract

Compared to the risks mentioned with corresponding financial burdens, the costs for the mentioned searches is negligible, even if one includes the costs of an attorney for evaluating the search results.

2.7.2 Filing Costs (German Trademark Application)

Speaking about costs, the costs for filing a trademark application are always an initial consideration. In this respect the following rule of thumb could be used. The official filing fee is € 300 while typical attorney's fees for representing and filing of a trademark application (1–3 classes) is in the range of € 600.

The attorney's fee mentioned above here represents an average value. Some attorneys charge more while others charge less. It often occurs that additional consultation is required which goes beyond the filing and registration procedure for a new trademark. In this situation, it is recommended that an hourly rate is negotiated with the attorney and that a cost estimate is obtained for the legal consultation. As an average hourly fee in Germany, one can expect about € 250 to € 450 for Patent Attorneys as well as Attorneys at Law.

3 Coexistence of Trademarks

The German trademark may coexist with:

- International Registrations under the Madrid Agreement (MMA) and the Madrid Protocol (MMP) as well as
- The Community Trademarks

3.1 Introduction of Madrid Agreement and Madrid Protocol

- (a) For more than a hundred years, the Madrid Agreement concerning the International Registration of marks has provided for the possibility of obtaining the protection of a trademark or service mark in several countries by means of a single International Registration. It was adopted on April 14, 1891 and revised on several occasions, but its main features have remained basically the same during the past century.
- (b) At the end of 2007, 57 countries are party to the Madrid Agreement. They are mainly countries from continental Europe (including the Russian Federation and most of the former Republics of the Soviet Union), countries in the northern part of Africa and four countries in the Far East: China, the Democratic People's Republic of Korea, Mongolia and VietNam. A number of countries which are very important in terms of trademark filing activity are missing in the Madrid Agreement. These are common law countries, in particular the United States of America and the United Kingdom, and also the Scandinavian countries, most of the Latin American countries, as well as Japan. However, these countries are meanwhile parties of the Madrid protocol (see Sect. 3.4) hereinafter).

- (c) Since the entry into force of the Madrid Agreement until end of 2007, some 950,000 International Registrations have been made. In view of the fact that each International Registration covers, on average, 10 countries, these 950,000 International Registrations are equivalent to about nine and a half million national registrations. It should also be taken into account that the Madrid system is a multi-class system so that one and the same International Registration may cover several classes of the International (Nice) Classification. The oldest International Registration which is still in force dates back to March 27, 1893 (the famous Swiss mark LONGINES for watches).
- (d) In fact, among the participating countries, the Madrid Agreement has been and continues to be a big success. Trademark owners in the member countries largely favour the Madrid system route for protecting their marks abroad, in particular because it is very simple, cheap and efficient.

3.2 Main Features of the Madrid Agreement

The main features of the Madrid Agreement can be summarized as follows:

- (a) First, the applicant must be a national of a country being party to the Madrid Agreement or a person having his domicile or a real and effective industrial or commercial establishment in such a country.
- (b) Second, the mark which is intended to be replaced internationally must first be registered at the national level by the Trademark Office of the country of origin of the applicant. That first registration is called the “Home Registration” and it must precede the International Registration.
- (c) Third, there is no direct filing with the International Bureau (WIPO) under the Madrid Agreement. The application for International Registration must be filed with the office of the country of origin, which will transmit it to the International Bureau (WIPO) in Geneva.
- (d) The role of the office of the country of origin is not only to transmit the application for International Registration to the International Bureau (WIPO), but also to certify that the mark which is the subject of the application for International Registration is the same as the mark which is the subject of the Home Registration, and that the goods and/or services for which protection is sought are covered by the goods and/or services for which the Home Registration is registered.
- (e) Fourth, the application form on which the international trademark application must be filed must contain, *inter alia*, the list of the countries party to the Madrid Agreement in which protection is sought (the so-called “designated countries”).
- (f) Fees are to be paid. Part of them belong to WIPO (and cover the expenses of the International Bureau in respect of the international procedure). There is also a designation fee which has to be paid for each designated country. It is called, in Madrid terminology, the “complementary fee” and its amount is the same for

each designated country. In addition, if the list of goods and/or services for which protection is sought covers more than three classes of the International (Nice) Classification, the applicant has to pay a “supplementary fee” for each class of goods and/or services beyond the third class.

- (g) Fifth, once all the required conditions have been met, including the payment of the fees, the International Bureau (WIPO) registers the mark in the International Register, notifies the International Registration to the offices of the designated countries and publishes it in a monthly periodical called “Les Marques Internationales”. Under the Madrid Agreement, French is the only working language and all communications to WIPO (including the international application) must be in French; that situation is changed under the Madrid Protocol.
- (h) A mark which is recorded in the International Register—and this is the sixth feature of the Madrid system—is subject to the same regime in each designated country as a mark filed with the national office of that country. During a period of 1 year, the office of each designated country has the right to declare, in a notification of refusal addressed to the International Bureau (WIPO), that protection cannot be granted in the country concerned, in respect of some or all of the goods and/or services covered, to the mark which is the subject of an International registration notified to the said office by the International Bureau (WIPO). That refusal must indicate all the grounds on which it is based. Those grounds may only be grounds that would be applied in the case of a national mark filed with the office which notifies the refusal. Therefore, an International Registration under the Madrid Agreement designating Germany is to be considered the same as the German national registration.
- (i) Seventh, if there is no refusal of protection within the prescribed time limit, or where a refusal has been withdrawn by the office of a designated country, the mark must be considered as registered in that designated country as of the “date of the International Registration”.
- (j) Finally, during the first 5 years from the date of International Registration, the validity of the International Registration is dependent on the Home Registration in the country of origin. If during those 5 years the Home Registration is cancelled, the International Registration no longer has any effect in any of the designated countries and it is cancelled at the request of the office of origin. The same applies when national protection in the country of origin has ceased as a result of an action before a court, begun before the expiration of a period of 5 years from the date of the International Registration (Article 6(3)). The possibility to attack the International Registration through the national registration in the country of origin is very often referred to as the “central attack” feature of the Madrid Agreement, because it gives the owner of a mark which is in conflict with the holder of an International Registration in several countries party to the Madrid Agreement the possibility of introducing a single action against the Home Registration in the country of origin, instead of introducing separate actions before the competent court of each designated country.

Repetitive: Main features of the Madrid Agreement

- a) Applicant must be a national of a country to the MMA
- b) Intended mark must first be registered at national level („Home Registration“)
- c) Application must be filed with the applicant’s national office
- d) Office certifies identity and transmits application to W.I.P.O.
- e) Application must contain countries where protection is sought
- f) Supplementary fees have to be paid
- g) Registration, Notification and Publishing through W.I.P.O.
- h) Registered mark is subject to same regime in each country
- i) Considered to be registered in designated country if not refused
- j) During first five years dependent on validity of Home Registration

3.3 Necessity to Amend the Madrid System

Although, as stated before, the Madrid system has been extensively used by trademark owners of the member countries for more than one century, the number of member countries has remained relatively low and has remained geographically limited. This is so because a number of features of the Madrid system have proved to be obstacles to accession for several States. Those features are the following five:

- (a) First, the necessity of obtaining, as a prerequisite to international registration, a Home Registration of the mark at the national level in the country of origin. Also, it insists in the word *registration* because, in many countries, the examination of

a trademark application takes a long time and a trademark registration is not easily and rapidly obtained.

- (b) Second, the relative shortness (1 year) of the time limit within which the designated office can examine the mark and issue a notification of refusal giving all the grounds for refusal.
- (c) Third, the system of fees, in particular the uniform fee paid for the designation of a country, is considered by some countries having a high level of national fees to be inappropriate, because such a country would receive less money under the Madrid system than under its national system.
- (d) Fourth, the fact that the International Registration remains linked to the Home Registration during 5 years and must be cancelled if the Home Registration is cancelled has been considered, in some countries, as being too strict, since the grounds for cancellation of the mark in the country of origin do not necessarily exist in each of the designated countries.
- (e) And finally, the fifth feature, the Regulations implementing the Madrid Agreement provide for a single working language, namely French.

Repetitive: Amendments to the Madrid System

- a) International application may also be based on a national application
- b) Time limit for refusal may be extended to up to 18 months by declaration
- c) MMA fee system and individual fee system may be chosen
- d) Conversion into national applications if Home application is subject to cancellation
- e) French is accepted as working language
- f) Possibility to intergovernmental organisation to join the Protocol

The Madrid Protocol addresses these issues, wherein the objectives of the Madrid Protocol are twofold. First, to attract new States to the Madrid System, in particular those member States of the European Community which are not yet party to the Madrid Agreement, but also countries like Japan, the United States of America and

other countries in Asia and in America. And second, the Madrid Protocol aimed to create a link between the Madrid system and the Community Trademark system.

3.4 Innovations Introduced by the Madrid Protocol

- (a) The first innovation is the following. Whereas under the Madrid Agreement an international application must be based on a national registration in the country of origin, under the Protocol an international application may also be based on a national (or regional) application.
- (b) The second innovation is the following. Whereas, under the Madrid Agreement, any notification of refusal by the office of a designated country must be sent to WIPO within a time limit of 1 year, the Madrid Protocol, while keeping that deadline as the basic deadline, provides for exceptions that are intended to allow accession to the Protocol by States that consider 1 year too short of a time for the office to communicate even provisional refusals. Under Article 5(2)(b) of the Madrid Protocol, any Member State can make a declaration to the effect that the 1-year time limit is replaced by 18 months.
- (c) The third innovation introduced by the Madrid Protocol is the individual fee system. Under the Protocol, any member state may choose between two fee systems. It can choose the existing Madrid Agreement system under which the designation of a Contracting Party is subject to the payment of a fee whose amount is the same for any member state to which that system applies. But a member state may also choose the so-called “individual fee” system which basically means that it can itself fix the amount of the fee which it wishes to receive whenever it is designated.
- (d) The fourth major innovation introduced by the Protocol is the possibility of transforming an International Registration which has been cancelled as a result of the loss of effects of the basis application, of the registration resulting therefrom or of the Home Registration (for example, in case of central attack) into national (or regional) applications in the designated member states. The said national (or regional) applications would benefit from the registration date of the International Registration and from its priority date under the Paris Convention, if any.
- (e) The fifth innovation introduced by the Protocol is that English besides French is accepted as a working language (on April 1, 2004, Spanish has become a third language).
- (f) As regards the creation of a link between the Madrid system and the Community Trademark system, the Protocol gives the possibility for an intergovernmental organization to become party of the Protocol where that organization has a regional office for the purpose of registering marks with effect in the territory of the organization. Since the European Community joined the Protocol on October 1, 2004, it is possible that an International Registration be based on a Community Trademark application or registration and, on the other hand,

Protocol applicants are able to designate the European Community in order to obtain, via the Madrid system, the effects of a Community Trademark registration.

3.5 The Madrid Protocol in Brief

The Madrid protocol represents an amendment to the Madrid Agreement, which should make the Agreement more attractive to non-member countries. Application is still restricted to national or legal entities of a Member State, and in addition, the application must be based on a national application in the home country of the applicant. However, the applicant can select the particular countries to be covered. As under the Madrid Agreement, the applications result in a bundle of national trademark rights, whereby use in each country is required to maintain the right in that country.

Effective on October 1, 2004 the European Union joined the Madrid Protocol, with the important effect that a Community Trademark can be obtained through an International Trademark application (“incoming PIR Mark”) and, based on Community Trademark protection, may be obtained in the Protocol member states (“outgoing PIR Mark”), both solely based on the Madrid Protocol.

3.6 Examples of Registrations under the Madrid Agreement (MMA) and the Madrid Protocol (MMP)

3.6.1 MMA-Registration

(151) 26.09.1997	680 227
(732) HERMES INTERNATIONAL	
(Société en commandite par actions)	
24, rue du Faubourg Saint Honoré, F-75008 PARIS	
(FR).	

TOGO

(551) 16 Porte-chéquiers.

18 Articles de maroquinerie en cuir ou imitation du cuir (à l'exception des étuis adaptés aux produits qu'ils sont destinés à contenir, des gants et des ceintures); sacs, à savoir sacs à main, de voyage, à dos; portefeuilles, porte-monnaie en cuir, porte-cartes (portefeuilles), étuis pour clefs (maroquinerie), porte-documents; malles et valises; fouets, harneis, selles et article de sellerie.

3.6.2 MMP-Registration

(151) **04.09. 1997**

680 609

(732) Cent holding ag

50, Wickererstrasse, D-65439 Flörsheim (Germany).



(531) 26.1; 26.4; 27.1.

(511) 35 Business management, business administration, management consultation.

36 Financial affairs, monetary affairs, real estate administration.

35 Gestion d'entreprise, administration commerciale, conseil en gestion.
























36 Opérations financières, opérations monétaires, administration de biens immobiliers

Based on these examples, one can see that within the territory of Germany, one must not only consider German trademarks, but also International Registrations deriving from the Madrid Agreement and/or the Madrid Protocol. These International Registrations are treated on the same footing as a German trademark. Just as with a German trademark, opposition and/or cancellation actions can be initiated with effect for Germany. However, if a Home Registration is being cancelled in part or in full, and if its corresponding International Registration is registered for less than 5 years, this International Registration will automatically be cancelled to the very same extent as the Home Registration (so-called “Central Attack”).

4 Community Trademarks

The Community Trademark Convention provides coverage throughout the European Union on the basis of a single trademark application. As opposed to the Madrid Agreement, there are no restrictions on the origin of the Applicant. He may be an EU national or non-national. A trademark right is obtained for all EU countries, while use in only part of the EU is required to maintain the right. At the end of 2007, the EU member states cover the following yellow marked parts of Europe:



 Austria	 Estonia	 Ireland	 Netherlands	 Spain
 Belgium	 Finland	 Italy	 Poland	 Sweden
 Bulgaria	 France	 Latvia	 Portugal	 United Kingdom
 Cyprus	 Germany	 Lithuania	 Romania	
 Czech Republic	 Greece	 Luxembourg	 Slovakia	
 Denmark	 Hungary	 Malta	 Slovenia	

The Community Trademark (CTM) system has been officially in effect since January 1, 1996, while the Trademark Office began full operation on April 1, 1996. The Trademark Office is located in Alicante, Spain, and is officially known as the Office for Harmonisation in the Internal Market (OHIM).

On May 1, 2004 the following ten countries joined the European Union: Cypress, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia. At that time, the EU consisted of 25 countries. This major change has affected the CTM system as follows:

- (a) All CTM registrations and applications filed before or claiming priority before May 1, 2004 have automatically been extended to the ten new Member States as from the date of accession.
- (b) It will not be possible to cancel CTM rights that are automatically extended under section (a) above on the basis of grounds, either absolute or relative, that exist only in the new Member States (with one exception relating to descriptive and immoral meanings).
- (c) Any potential harm caused to local traders by the provision set out in sections (a) and (b) can be addressed by existing provisions in the CTM Regulation.
- (d) It is not possible to the owners of automatically extended CTM rights to prevent the use of trademarks that existed in a accession State prior to the accession date.
- (e) CTM applications with a filing or priority date of May 1, 2004 (the accession date) or later, have effect in all 25 countries and are treated in the usual way. From then on, it is possible to raise absolute or relative grounds of objection that are applicable in any of the 25 member States. Accepted CTM applications are also published in all of the EU's official languages.

On January 1, 2007, a further enlargement of the European Union took place: Bulgaria and Romania joined in. Since then, the EU consists of 27 countries. This enlargement had the same effects on the CTM system as the previous one.

4.1 Application Requirements

An applicant shall be a national of a member State of the Paris Convention, but need not be a national of a Member State of the European Union. Non-Europeans must be represented by a qualified professional.

A CTM application need not be based on an earlier national application, although filing will often be based on a priority claim. The CTM can be filed in any of the languages of the EU Member States, while one alternative official language (English, German, French, Italian or Spanish) must be specified, for example for possible Opposition proceedings. The filing in Alicante can also be made by electronic mail or facsimile. In addition, applications may be filed at the national trademark office of any Member State of the European Union.

In Summary: Application Requirements

- (a) Applicants shall be a national of a member State of the Paris Conention.
- (b) Applicant does not need to be national of the European Union.
- (c) Non-Europeans must be represented by a qualified professional.
- (d) No need for earlier national basic application, often priority claim.
- (e) Application can be files in any of the 20 languages of the EU States.
- (f) Filing with OHIM in Alicante my be electronic or by facsimile.
- (g) Additional applications may be filed at the national Trademark office.

4.2 Examination and Registration

Upon registration, the OHIM will perform a search of prior CTM applications and registrations with respect to similarity with the filed mark. The results of this search will not be used for refusal, but are sent to the applicant as well as to the owners of the relevant CTMs found in the search. After publication of the application, the owners of these and other CTMs have the option of filing an Opposition.

The OHIM itself will not search national registrations, but the trademark offices of several of the member states will conduct a search for any earlier national marks which could lead to an objection and will communicate such marks to the OHIM in order for them to be included into the search report. Only the Patent and Trademark Offices of France, Italy and Germany do not provide a search report, because these countries have a different principle in opposition, i.e., the Patent Office does not examine relative bars to protection of its own volition.

An example of a CTM publication is given below:

210 000168807
 220 01/04/1996
 442 17/11/1997
 546



531 1.15.11, 20.5.15, 25.5.2, 27.5.13
 731 C+D Consult & Design GmbH
 Im Mittleren Sand 48A
 65936 Frankfurt
 Germany
 740 Meissner, Bolte & Partner
 Widenmayerstraße 48
 80538 Munich
 Germany
 270 DE EN
 511 ES-25-clothing, in particular children's clothing, shoes.

4.3 *Opposition*

An opposition period of 3 months runs from the publication date, within which the owner of any prior conflicting mark may oppose the CTM registration. If refused in opposition proceedings, the application may be converted into separate national applications, for example in the countries where the prior conflicting rights do not exist.

If at least one opposition has been filed, an extendable “cooling off period” of initially 2 months commences in order to provide for time to negotiate a settlement of the opposition between the parties.

Repetitive: Opposition

Opposition

- a) Opposition period of three months from publication date
- b) CTM-Application may be converted into separate national applications
- c) Extendable „Cooling off period“ of initially two months

4.4 *Seniority*

To allow for a transition from national registrations to the CTM, a seniority claim is available. A CTM application may claim seniority from a previous national registration in any Member State. This will permit Applicant to make a CTM application covering all of the European Union Member States, while at the same time retaining his protection rights back to the filing date of his national registration. Having obtained the seniority right in the CTM application, the national registrations can be abandoned without loss of rights.

Repetitive: Seniority

Seniority

- a) Application may claim seniority from a previous national registration
- b) Having obtained seniority right, national registration can be abandoned

4.5 Registration and Use

The CTM has a duration of 10 years, after which renewal is possible without the necessity of filing proof of use. Validity of the mark requires use in any part of the European Union. The registration is subject to cancellation if it has not been used within the Union over a continuous period of 5 years.

Repetitive: Registration and Use

Registration and Use

- a) Duration of 10 years, after which renewal is possible without filing proof of use
- b) Subject to cancellation if not used over a continuous period of five years

4.6 Litigation

Infringement and invalidity with respect to the CTM are dealt with by the respective national courts under national law. A CTM may be revoked in view of conflict with prior rights, including a prior right anywhere in the European Union. This may be the one disadvantage of the CTM system. However, the CTM can be converted into national applications.

The CTM registration provides a single unitary right throughout the EU. Assignments or licenses with respect to the mark are registered at the OHIM. Being unitary, the trademark cannot be separately assigned to different parties for separate countries. However, it can be licensed to different parties for separate countries.

From these short remarks on the Community Trademark it can be recognized that such marks for Germany are just as important as national German trademarks. Actions can be taken against the Community Trademark out of prior national German marks or, on the other hand, rights can be derived from Community Trademarks against newer national trademark applications.

In summary, the German trademark competes in Germany not only with German designation rights, but stands on the same footing with:

- International Registrations under the Madrid Agreement and/or Madrid Protocol which designate Germany, as well as
- Community Trademarks

Repetitive: CTM-Litigation

CTM-Litigation

- a) Infringement and invalidity are dealt with by national courts and law
- b) CTM may be revoked in view of conflict with prior rights in the EU
- c) German Trademarks are equivalent to IR-Marks and CTMs

4.7 The “Link”: Interaction Between the Madrid Protocol and the CTM System

The “link” between these two systems provides for the possibility of designing the European Union as one single region as CTM in a Protocol application (“incoming PRI Mark”) or to base a Protocol application as “home applications (“outgoing PIR Mark”).

Regarding the question whether an applicant should seek protection in the European Union directly by filing a CTM application or through the protocol, the following is important to note. There is a 5 year vulnerability of a CTM as part of a protocol registration which provides for risk of that CTM being turned down together with the Protocol registrations following a successful “central attack”. This may be an argument against this way. However, even in such case, a conversion of a CTM into a national application remains available.

An “outgoing PIR Mark” is in any case solely available to EU nationals since the basic CTM application must act as home application. For EU member states signatory to both the Madrid Agreement and the Madrid Protocol, an outgoing PIR Mark on the basis of a CTM application may also be disadvantageous because of significantly higher official fees payable for each Protocol designation.

5 Summary

5.1 What is a Trademark?

A mark distinguishes goods and services from those of another enterprise. Marks are the names, which “personalize” the product or service. A mark ensures the quality of the goods (guarantee and trust), the recognition of a product (advertising and origin) and the better quality (quality function).

The mark should also ensure the quality of the goods (guarantee and trust) as well as recognition of a certain product (advertising and origin) of the same or better quality (quality function) together with the technical advancement. The recognition function of a mark by the consumer and the control function of the owner of the mark was again confirmed by the European Court of Justice in the “Ideal Standard” decision dated June 22, 1994 (published in GRUR Int. 1994, 614 et seq.). The mark is therefore an instrument of consumer protection.

5.2 According to Section 3 German Trademark Act, Marks Can Be Registered in the Following Forms

1
Word
Marks

Pattex
Fa
Sidol
Persil

2
Picture
Marks



3
Word
& Picture
Marks



4
Numbers



5
Groups
of Letters



6
Colour
Combinations



7
Sounds



8
Three
dimensional
shapes and
packaging



5.3 *How Does a Mark Originate?*

Marks are born of the human imagination.

Persil The name originates from **Perborate** and **Silicate** (the prefixes of the names of chemicals).
It is interesting to note that the Imperial Patent Office did not consider Persil fit for protection. In 1917 the word Persil was registered on the basis of its notoriety. Today it would of course be assessed quite differently.

Henko From the manufacturer Henkel

Düssan From Düsseldorf (modification of geographical name)

Carclin Modified spelling of CAR-CLEAN

Ata Imaginary word

Word & Picture Mark Comic figure with imaginary word Pril

5.4 *How Does Trademark Protection Originate?*

Registered trademark protection rights are obtained by application and registration at the competent authorities. Normally these are patent offices or trademark offices in the various countries. In Europe, the Community Trademark Office (OHIM) is also available for filing a Community Trademark (CTM).

In Germany, the German Patent Office in Munich with its branch office in Berlin is the competent office. Upon entry in the Trademark Register, a sign becomes a registered trademark. The sign may (but need not be) marked with the sign ® which equals registered mark. For well known marks, the proprietor often does not use an ®, such as for *Boss* or *Mercedes*. However, for less well known marks, also with additional elements it is recommended as follows:

Ferrolix®

STABILOX® PBS 1026

Ferrolix® 8350

Sekusept® plus

Balance®

For weaker marks, the ® should be used such that the presence of trademark protection is visible. For example the trademark Balance (registered by Goldwell AG, Darmstadt) appears almost descriptive especially when seen on the packaging or in advertising with the words “skin balance” or “maintains the natural balance”, etc.

5.5 Why Seeking Trademark Protection?

A registered mark provides industry with protection from mark pirates, infringers and inadvertant imitators. Mark pirates are extremely detrimental to the economy. Well known marks such as the Lacoste crocodile, Rolex, Pattex, Creme 21, Persil, etc. are often popular mark pirates’ imitations. Concerning such imitations, see below:



Original

Imitations

Original



Imitations



Originals



Imitations

Original



Imitation

Mark piracy appears in many forms. While in some countries almost slavish imitation is rife, in western countries where the law is effective, imitations are more subtle. Leading market products are copied in such a way as to make the consumer think that imitations are another mark of the known manufacturer as can be seen from the following comparison between originals and corresponding imitations:



Original



Imitation

The trademark protection law makes it possible for the owner to take legal action against imitators and pirates. The laws and their implementation are different in every country, however, the *registered trademark* is the best means for defense. Thus, trademark protection is very important.

As already mentioned, the trademark also protects the consumer because he can expect the same or even better quality of the known product, especially for pharmaceuticals, etc.

Marks should not be ridiculed or satirized in such a way as to damage or exploit the goodwill associated with them.



5.6 What Other Dangers Face Registered Marks?

Registered marks can lose their protection when they are used in a generic sense, e.g., the mark "Vasolene" for mineral fat was previously protected (still protected in the USA), the mark "Kleenex" for facial tissues or "TEMPO" for tissue-handkerchiefs. The mark "Nylon" for synthetic fiber has also become a so-called "free sign" open to the public domain (generic designation), because the proprietor failed to prohibit third parties from use of the mark in describing similar goods.

Did you know for example that the word "WALKMAN" is a registered mark? Only the proprietor or licensee may use this sign on their products. The goods of other manufacturers use words such as walk player, cassette recorder, etc.

Thus, it is actually detrimental to use a registered mark in the form of a verb, e.g., the mark "PRITT" in advertising as "PRITT ALONG TOO".

PRITT is a trademark for a glue stick. If used in the form of a verb, PRITT could one day replace the word "glue". Then trademark protection would be lost!

For another example, the company Henkel owns the mark "MEGAPERLS" for detergents. The detergents are presented in the form of small balls and look like little pearls. The trademark owner would be ill advised to speak of the newly developed detergent as the "Megaperls" in the descriptive sense of "Mega Pearls". In this manner, good trademarks can become generic expressions and therefore become available to the public for use by the competitors.