

# INTERNATIONAL BRIEFING

## Dear reader,

The date of fate for Brexit approaches. Whatever the decision, “no deal“ or an orderly transition phase, the decision will have a significant impact on our economy and thus on our activities. We have therefore revisited Brexit related questions around commercial and corporate law for you in this edition of our newsletter International Briefing.

Another continuously hot topic in Germany and the EU are the stricter rules for controlling and approving foreign (non EU) direct investment, and you will find an update in this edition.

In October the Delaware Court of Chancery ruled on a material adverse change clause (MAC) as a termination ground in a large scale merger agreement – we look at this notable decision in the context of international M&A transactions.

We also inform on new recent legislative initiatives and developments in German corporate and energy law, further implications due to the 5th EU Money Laundering Directive in Germany, new developments around paid leave resulting from a judgement of the European Court of Justice and provide a high-level overview on legal questions around streaming of games.

Last but not least, on 24 November 2018 our partnership elected Philipp Cotta as its new managing partner. In recent years, Philipp Cotta was a member of our Steering Committee and particularly responsible for international matters. Dr Detlef Koch, Dr Guido Krüger, Oliver Schwarz and Dr Axel von Walter were elected as members of our Steering Committee.

We wish you happy holidays and a great start into the New Year 2019!

Best regards,



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## Brexit – A United Kingdom lost

When this article lands in your inbox, predictions as to where the long and winding road (of Brexit) will lead will not be in short supply, but come with a short lifespan.<sup>1</sup> One thing is certain, the withdrawal exercise has already been very costly and should the withdrawal of the UK from the EU go ahead, the future costs will be substantial. Additionally, the United Kingdom of Great Britain and Northern Ireland is experiencing a constitutional crisis over the devolution of powers between the UK's constituent countries (England, Scotland, Wales and Northern Ireland), a potential follow-up referendum on Scottish independence and Irish re-unification.

Moreover, Brexit will have lasting impact on the economy, population and politics in the UK and beyond. The economy will shrink and the population will become less diverse. The EU and UK's influence on the world stage will decrease both economically and politically and at an accelerated rate.

<sup>1</sup> The lyrics of the Beatles' song of 1970 predate the UK's accession to the then European Communities and will remain with us for much longer.

## Introduction – Risks and Challenges ahead

At 11 pm local time on 29 March 2019, the UK is scheduled to leave the EU28. But wait: On 10 December 2018, the Court of Justice of the European Union held that the UK can unilaterally revoke its intention to withdraw from the EU (Case C-621/18).

And on the same day, the vote scheduled for 11 December 2018 in the Parliament of Westminster was cancelled. What will happen now?

Moreover, even if a no-deal scenario is avoided and the Withdrawal Treaty is accepted by Westminster, the crucial issue of the future trading framework between the EU and the UK remains unresolved. The Withdrawal Agreement does not resolve uncertainties but leaves them, and the Brexit risks and challenges, waiting for a future negotiated solution.

Article 50 of the Treaty of the European Union creates this two-step approach. Accordingly, the UK and the EU merely agreed on a „Political Declaration setting out the Framework for the Future Relationship between the EU and the UK“. This masterpiece of fudge and vagueness establishes that negotiations about the principles and details in minutiae will start at the earliest in January 2019 and that the parties agree to “a new deep and special partnership” during the transition period. The parties wish to create a free trade area for goods, agree on an “ambitious, comprehensive and balanced services and investment relationship”, conclude accords on transport, etc.

At this time, it is not possible to anticipate what precisely will be agreed. It is even possible that nothing will be agreed. This entails serious risks and challenges for the road ahead.

## General remarks on key risks and challenges

The range of risks resulting from the UK's withdrawal from the EU is broad and the impact depends on the activities concerned, be it sale of goods, cross-border manufacturing operations, providing services or maintaining a commercial or manufacturing presence in the UK or the EU27. Irrespective of the outcome of future negotiations, it is certain that Brexit will generate additional costs and challenges for all economic operators, both in the UK and in the EU27. As the outcome of the negotiations on the future framework remains unclear, businesses need to prepare themselves by identifying and addressing risks in advance.

Even though the risks depend on the particular activities of a company, we can group them into several broad categories that every business (and its subsidiaries) should evaluate:

- The entire manufacturing and supply chain should be reviewed and (re-)considered in light of Brexit.
- All contracts related to the UK, which will still be valid or have effects after April 2019 or, should the Withdrawal Agreement be signed at the end of the proposed transition period, in December 2020 should be reviewed and eventually modified or terminated.

- All cross-border shareholdings between the UK and EU27 countries that will continue or have effects in April 2019 or after December 2020 should be reviewed and eventually modified.
- All future movement and postings of persons and goods must be Brexit-proofed.

In detail:

### MANUFACTURING AND SUPPLY CHAINS

Brexit poses the greatest risks and challenges for manufacturing and supply chains, irrespective of whether the Withdrawal Agreement enters into effect or a subsequent free trade agreement, if any, is concluded and what such an agreement may provide. From the outset, it should be emphasised that all known EU rules concerning free movement of goods, services, capital and people between EU countries and the UK will no longer apply. The UK intends to apply many EU rules on a temporary basis and may change these at the latest after a potential transition period. Disruption is guaranteed.

If the Withdrawal Agreement is not signed, in a no-deal situation the UK must be treated like any other non-EU-country when evaluating the consequences of Brexit and the possible need for action. This means the movement of goods between the UK and any EU27 country will be subject to customs control and the payment of duties. The UK has indicated that it plans to keep tariffs at similar levels as the current EU28 tariffs for industrial products, which will result in additional costs in manufacturing and supply chains. The burden for companies that carry out production steps in different countries will increase significantly, as will the costs of doing business. For example: if a gas heating system made in Germany is installed in a motor vehicle manufactured in the UK, which is then sold in France, duties will have to be paid on the gas heating system in the UK and duties on the vehicle in France. Duties on the imported parts may possibly be refunded, but this will require further efforts and possibly delays.

As the shipping conditions change to those applicable to businesses in a third country, additional regulatory burdens for customs documents, taxes and import turnover tax will arise and pose challenges. Delays in crossing the UK/EU border are a likely result of additional export/import controls. This needs to be taken into account upfront.

If the Withdrawal Agreement is signed, these additional burdens will be imposed at the end of the transition period; a free trade agreement, should one be concluded, will only reduce these additional burdens to some extent. Indeed, such an agreement can avoid the levying of customs duties on goods originating within the area, but can lead to additional controls. Currently, once goods have cleared customs in one EU country, they can circulate freely within the EU. Moreover, physical movement between countries for goods and persons will be subject to agreements on (air, road, rail and sea) transport.

At the latest after the transition period and the time necessary for the British legislature to enact changes, product requirements will diverge (assuming that the UK will in fact (de-) regulate). Issues of

certification (within the British, EU and other markets), recognition of certifying bodies and costs for meeting standards will pose additional challenges for manufacturers. Today, there is a one-stop-shop for chemicals, medicine, medical apparatus, pharmaceuticals, etc. On Brexit day, decades of progress towards frictionless trade will become history, with the irony that it was the UK that pushed for the completion of the single or internal market in the 1980s!

Additionally, tax-related issues have to be taken into account; for further details please see below.

For all of these reasons, manufacturing and supply chains must be analysed in terms of economic viability and cost-effectiveness, and adapted if necessary. Irrespective of the Withdrawal Agreement and the envisaged free trade agreement, companies should evaluate their costs and exposure. They should review manufacturing and supply chains with their most important customers and suppliers:

- Identify the most important suppliers for each manufacturing site or operation. While economic importance will be key to identifying the importance in the manufacturing and supply chain, attention must be given to smaller, but strategic supply chain relationships which could have a big impact on both production and supply as well.
- Analyse supplies to and from the UK:
  - How should supply chain relationships be configured, in particular will they be maintained or replaced, and how will contracts be adapted? For details see below “Contracts related to the UK”.
  - How will the company react to a foreseeable delay? Do you need to build-up stocks, look for alternative suppliers, etc.?
  - How will the company react to increasing costs and who will bear them? Increased costs through customs duties, import turnover taxes, logistics, certifications for products, etc. need to be assessed and taken into account in business planning. Future contracts should include terms to apportion responsibilities for costs and risks; for details see below under “Contracts related to the UK”.
  - If movement of people is restricted, which location should be used to provide services (installation, repair, maintenance)?
  - If applications for industrial property rights (especially EU trademarks and community designs) were filed, which ones will need to be filed or renewed in the UK or the EU27 after Brexit?
  - If there are products with CE certification, which ones might have to meet new UK safety standards?
  - Are IT systems prepared to handle new requirements for customs and statistical declarations, or can they be adapted? Possible diverging data protection requirements in the processing of data should be taken into account.

- Identify the most important customers that are supplied from different factories.
- Analyse customers located in or supplied by the UK:
  - How should supply chain relationships be configured post-Brexit, in particular should they be maintained or replaced, and how should contracts be adapted? For details see below under “Contracts related to the UK”.
  - How should the company manage increased costs and who should bear responsibility for these costs and risks?

### CONTRACTS RELATED TO THE UK

Irrespective of the Withdrawal Agreement being concluded and a free trade agreement being reached, Brexit will cause additional costs and challenges. Contracts that will remain in effect beyond Brexit need to be examined closely. Some long-term contracts may no longer be adequate and need to be adapted or terminated. For new contracts that will still be valid after Brexit, the distribution of costs and responsibilities for risks should be taken into consideration when negotiating the contract and be spelled out in clear terms.

A key aspect that needs to be reviewed and (re-)considered in contracts is the apportionment of additional risks and costs as a result of Brexit. These can be caused by border delays, shortage of supplies, additional export/import controls and newly arranged documentation requirements. Modifications regarding the modalities for the submission of documents and licenses, customs, VAT and import-turnover tax will give rise to long-term costs.

Furthermore, increased staff costs for services requiring the movement of people (e.g. for installation) must be taken adequately into account.

In addition, in the case of territorial limitations or industrial property rights, it should be considered whether the contract still includes the UK after Brexit. If this is not the case, an evaluation should be performed as to whether it is appropriate to adapt the contract in question.

In most cases, the risks associated with Brexit will not have been calculated and taken into account, nor will the attribution or sharing of responsibilities for new risks have been agreed and set out in the contract. Rarely will it be possible to terminate a contract because the implicit basis of the contract no longer exists (which can lead to an adaptation of the contract under German law) or for “frustration” (which can lead to termination of a contract under British law).

Irrespective of the conclusion of the Withdrawal Agreement and a free trade agreement, a company should:

- Identify the most important contracts (as deemed necessary for manufacturing and supply chains).
- Review the distribution of costs and the attribution of responsibilities for risks, taking into account the applicable law.
- In particular, review the distribution of additional costs and the allocation of responsibilities for risks arising from delays,

additional services, additional approvals required (safety and certification standards) and for impossibility to fulfil a contract.

- If these elements are not yet defined, review whether it will be possible to terminate or adapt the contract.
- Review which applicable law and jurisdiction were agreed upon.
- Adapt or terminate contracts with greater risks, if possible.
- Consider hedging for currency fluctuations.
- Conclude new contracts with an appropriate distribution of costs and attribution of risks, taking into account the choice of law and jurisdiction, and possibly arbitration rather than court proceedings in the case of dispute.

## CORPORATE LAW

Post-Brexit and the transition period, companies established and operating in the UK will no longer have to abide by EU rules and will no longer benefit from EU rules with respect to their subsidiaries in EU countries, unless UK law or international or bilateral agreements apply rules that are similar or identical to EU law. EU regulations regarding disclosure, incorporation, transparency, capital maintenance and alteration, cross-border restructurings and mergers will no longer apply to the UK. The same is true for rules on the common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, and on the elimination of double taxation within corporate groups from profit distribution between related EU companies. Whether or not this will have consequences for the company has to be examined in detail and solutions for any negative developments must be sought.

Over time, UK corporate law may start to deviate from the current EU law requirements, since it will no longer have to comply with EU regulations. UK companies hoping to establish a branch in the EU will, in principle, be subject to the more extensive disclosure formalities applicable to branches of non-EU companies. They will be treated as “third country companies”.

Companies that use the English legal form of limited company but are located in EU Member States will no longer be able to rely on the right of establishment granted by the European treaties. After Brexit, limited companies resident in Germany, for example, will no longer be regarded as corporations, but they will be subject to the rules for partnerships and might lose their limited liability status. As a consequence, shareholders of such limited companies may be personally liable without limitation.

An EU Member State may in the future require companies resident in the UK to appoint a fiscal representative when they register for VAT within the EU. The representative usually takes on joint and several liability for the VAT debts and accounts of the company.

Finally, Brexit will have consequences for European works councils, since the EWC agreements under UK law will not automatically endure. If the agreements are not renegotiated, EWCs will lose their UK members.

Companies must:

- Identify agreements concerning dividend and royalty payments, supplies as well as the supply of goods and services within the corporate group.
- Review which tax regulations apply if EU regulations are no longer applicable (see as a fall back double taxation agreements).
- Calculate the financial consequences of the upcoming changes and consider optimisation measures.
- If changes to the group structure are already being considered, review whether it is appropriate to implement them before or (if still useful) after Brexit.
- Determine cash flows within the company group and whether they need to be adapted.
- Determine whether there are accumulated profits and losses and whether they may be claimed or offset post-Brexit.
- If you have a limited company established in an EU27 country, prepare the appropriate adaptations under corporate law.

## Conclusions

In our view, the above-mentioned points are the most important issues that you need to consider. However, every business is different and will face different risks and challenges as a result of Brexit. Tailored legal advice is therefore strongly recommended.

In sum, irrespective of whether Brexit happens or not, it provides companies with an incentive to review, modify and reconfigure their manufacturing and sales chains, in order to future proof them.



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## The EU's path to uniform and stricter standards for screening foreign investments

The European Union is moving towards uniform and stricter rules for controlling and approving foreign direct investments. This follows the trend set by national governments, among others in Germany, the UK and the USA, as we explained in our article in the [September 2018 Newsletter](#) entitled "Germany's tighter FDI regime and the EU's path to uniform standards".

Following the reflection paper on "Harnessing Globalisation" of May 2017<sup>2</sup> and President Juncker's State of the Union Speech, the European Commission proposed a framework for screening direct investments in September 2017<sup>3</sup>. One year later, the European Parliament, Council and Commission reached a political agreement.<sup>4</sup>

Article 3 para. 2 of the proposed framework allows the Commission to "screen foreign direct investments that are likely to affect projects or programmes of Union interest on the grounds of security and public order".

### The importance of FDI in the EU

The proposal is particularly important since the inward foreign direct investment (FDI) at the end of 2015 reached EUR 5.7 trillion in the EU, whereas it is lower in the US and much lower in China. The largest foreign investor in the EU is still the US; although, their share fell from 51.3 % in 1995 to 41.4 % in 2015. Likewise Japan's share fell; it held 7.7 % of FDI in 1995 and less than 3 % in 2015. The shares of Brazil and China, on the other hand, have increased significantly. Brazil's share rose from 0.2 to 2.2 % and China's shares rose from 0.3 to 2 % between 1995 and 2015.

Although foreign investors control only 0.4 % of EU companies, these companies are generally much larger than companies owned by EU investors. The companies owned by foreign investors represent circa 13 % of total EU turnover, 11 % of value added and 6 % of total employment in the EU.<sup>5</sup>

### THE BENEFITS FOR INVESTORS AND THE ISSUE OF A LEVEL PLAYING FIELD

Third country investors seek to make use of the benefits of the internal market. Investing in EU companies offers them access to the entire EU market.

Considering the recent rise in the number of new restrictive measures adopted by foreign countries, the European Union considers the creation of a level playing field crucial. This can promote comparable investment conditions in foreign countries for EU operators. The EU's trade and investment policy is the best tool to

ensure that third countries will offer the same level of openness for foreign investment as the EU.

The European Commission's analysis in its "Reflection Paper on Harnessing Globalization" issued in May 2017 showed that the European Union must allow investments in order to ensure that innovative companies have access to finance. This can be achieved by investment-friendly regulatory frameworks for investment from within and outside the EU. Investment will contribute to economic growth, jobs and innovation.

On the other hand, FDI also presents some challenges. Companies use the lower standards of other countries to their advantage and, as a result, gain an advantage over competitors that produce within the EU. Furthermore, legal immigration can cause problems if integration fails. Especially in regions with high unemployment, protectionism can be triggered.

### THE ENVISAGED RULES

At the core of the framework is the protection of Europe's strategic interests and assets, such as energy, raw materials, cybersecurity and electronic communications, while at the same time remaining open to foreign direct investments. This is to be achieved by encouraging a dialogue between the European Commission and the Member States, allowing for the exchange of information, concerns and opinions about foreign direct investments, especially if such investments have the potential to affect several Member States at the same time. According to Article 8 of the proposed framework, Member States shall inform the Commission and each other of any direct foreign investments that undergo screening under their screening mechanisms. If one Member State is concerned about the effects of a foreign direct investment to its security, it may issue a comment and request any necessary information.

According to Article 9 of the framework, the European Commission may issue opinions if projects or programmes of Union interest could be affected.

Nevertheless the ultimate decision on whether to allow any foreign operation will remain with the Member States. In accordance with Article 5 of the proposed regulation, Member States have the responsibility to decide about their own national security interests and whether to establish their own protection mechanisms or refrain from doing so. And as stated in Article 6, Member States shall define the circumstances leading to a screening as well as the reasons for a screening and the detailed procedural rules. Almost half of EU Member States have a screening mechanism already in place. While the approaches are different, there are two main systems. Some require investors to notify an investment before it is made and provide for prior authorisation, while others require ex post control of investments that have already been completed. The areas protected by these mechanisms also differ. Some Member States focus on their national security inter-

<sup>2</sup> European Commission, "Reflection Paper on Harnessing Globalisation", COM(2017) 240 of 10 May 2017, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017DC0240>

<sup>3</sup> European Commission, Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union, COM(2017) 487 of 13 September 2017, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017PC0487> and the Staff Working Document available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017SC0297>

<sup>4</sup> European Commission Press Release "Commission welcomes agreement on foreign investment screening framework" of 20 November 2018, [http://europa.eu/rapid/press-release\\_IP-18-6467\\_en.htm](http://europa.eu/rapid/press-release_IP-18-6467_en.htm)

<sup>5</sup> Communication COM(2017) 494 of 13 September 2017, "Welcoming Foreign Direct Investment while Protecting Essential Interests", <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017DC0494>, p. 3 f.



ests, especially the production or trade in arms; others also cover the protection of public security, public policy and public order. These mechanisms may infringe the freedom of capital and establishment, especially if applied to intra-EU investments. However, the Treaty on the Functioning of the European Union allows Member States to take measures of this nature if the measures do not discriminate on grounds of nationality and can be justified by the needs of public security or police or other overriding reasons in the general interest as defined by the Court of Justice. In addition, the measures must comply with the principles of legal certainty and proportionality.<sup>6</sup>

As mentioned in its press release of 20 November 2018, „Commission welcomes agreement on foreign investment screening“, the Commission already analyses the foreign direct investment flows into the European Union and has set up a coordination group with Member States in order to help identify common strategic concerns and solutions.

## Conclusions

The EU's agreement on foreign investment screening aims for higher standards regarding investment control. It will drive the harmonisation of the different systems applying (or not) in all EU countries which may over time lead to a standardized and possibly more (cost) efficient handling of FDI controls. Moreover, it will help balance foreign and European investments within the EU and thus prevent a protectionist policy in economically weaker countries. The intention is to protect the EU as a whole and to create a free, open and fair foreign investment strategy on a global level.



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## Termination of M&A transactions based on MAC clauses

On 1 October 2018, the Delaware Court of Chancery recognised a material adverse change (MAC) clause as a means to terminate a share purchase agreement in the case of *Akorn vs. Fresenius Kabi*. This text looks at the general significance of MAC clauses, the specific conclusions of the US Court and the practical relevance of the judgment for M&A transactions.

## Backdrop and substance of MAC clauses

Company acquisitions can be quite protracted. Many months can pass between the signing of the sale and purchase agreement and closing. During this time, the company to be purchased can undergo radical changes, making the original calculations with respect to the target company invalid. This can be as a result of sudden financial or economic crisis, strong currency fluctuations, changes to key figures, e.g. EBIT or EBITDA, loss of key customers, substantial compliance incidents or other events that have a significant economic effect on the company. The “Material Adverse Change clause” or “MAC clause” (also called “Material Adverse Effect” or “MAE” clause) is designed to allow the purchaser to reconsider or even terminate the agreement in such situations.

A MAC clause functions as a contractual right of rescission pursuant to German law. It is a contractual provision, which (normally) allows the purchaser to withdraw from the contract before closing where there are substantial changes to circumstances.

The reason for such clauses is that, as a rule, a purchaser will have no or only limited influence over the target company before closing, but still has to accept a later worsening of the target's position – whether due to factors internal or external to the target. This distribution of risk seems unfair and unpractical from the purchaser's point of view, especially when external financing agreements give investors rights against the purchaser and allow them to cancel the financing agreements (known as back-to-back loans).

A MAC clause, and in particular the circumstances that will allow the purchaser to withdraw from the contract, will differ from case to case and depend on the contractual partners. There is broad consensus that a MAC clause should only relate to circumstances that are beyond the control of the purchaser, as the purchaser would otherwise not need the protection.

In practice, any MAC clause must be clear and must accurately state the cases in which a material adverse event will be accepted. The clause should establish and specify the grounds for a withdrawal from the contract in as much detail as possible and, where viable, these grounds should also be objectively verifiable. Such clauses therefore normally refer to an adverse effect on the assets, financial position or profits or make a link to economic indicators. In addition, the contracting parties often agree to carve outs, which in turn prohibit the use of the contractually agreed right of rescission in certain circumstances. In our experience, when a contracting party (most often the purchaser) uses a MAC clause, it is not to terminate the contract, but rather to re-negotiate the purchase price.

## MAC clause recognised for the first time in *Akorn vs. Fresenius Kabi*

Until now, there have been few judgments on MAC clauses in the Anglo-American world and in each case the court held that there had been no material adverse effect. German courts are yet to deal with MAC clauses.

<sup>6</sup> See above Note 3, p. 7 f.

The case before the Delaware Court of Chancery of 1 October 2018 concerned the following facts:

In 2017, Fresenius Kabi AG, a German healthcare company, announced that it was going to take over Akorn Inc., a US generic pharmaceutical company. Shortly after signing, Akorn's financial performance deteriorated significantly, with turnover sinking by 25 % and operating profits by 105 %. These negative developments continued into the first quarter of 2018. In addition, Fresenius received information at the end of 2017 concerning serious breaches of data protection law and issues with Akorn's compliance with the US Food and Drug Administration regulations.

When Fresenius relied on the agreed MAC clause and refused to close and terminated the sale and purchase agreement in April 2018, Akorn filed a claim for specific performance with the Delaware Court of Chancery.

As the first US court to find that the use of a MAC clause was justified, the Delaware Court of Chancery held that there had been a sufficiently serious adverse change, which would justify Fresenius' termination of the contract.

As part of its assessment of whether there had been a significant change, the Court analysed the profit-oriented EBITDA figures and compared these with the figures from the same quarter of the previous year. These showed a drop of between 55 % and 62 %. The Court considered this fluctuation sufficiently serious to justify the use of the MAC clause.

The Court found also that the right of termination was not precluded. While the MAC clause in the contract did not allow Fresenius to terminate the agreement when the industry in general was facing difficulties, the Court held that Akorn's problems were company-specific and, in comparison to competitors, Akorn had faced particularly sharp drop in EBITDA. The material adverse effect in this case was not due to industry-specific factors.

The Court also did not rule out the exercise of the right of termination because Fresenius had gained knowledge of the difficult circumstances as part of its due diligence: the purchaser's knowledge would only exclude the use of a material adverse effect when this was expressly provided in the contract. There was no such provision in the agreement between Fresenius and Akorn.

## Conclusion

The current judgment is important for future court cases, even if it is not revolutionary. The strict case law of the US Courts was continued in this case and resulted, for the first time, in the acceptance of the exercise of a right of termination on the basis of a MAC clause. The jurisprudence has therefore gained shape.

Moreover, the judgment of the Delaware Court of Chancery significantly refined the requirements of MAC clauses. Even if the Court did not provide a crystal clear definition of a material adverse effect and was careful to avoid specific figures, the judgment provides some guidance on the specific circumstances that are likely to constitute a material adverse effect.

The judgment also showed that the Courts will use the wording of the MAC clause as orientation. It is therefore recommended that any MAC clause – also outside the US – should be detailed and clear. This is on the one hand an advantage for the purchaser, because it will make it easier to show that the requirements for the use of the MAC clause are met, and establishes the specific findings to use to assess whether there has been a material adverse effect. On the other hand, a clear and detailed MAC clause is also an advantage for the seller, because they can reliably assess whether a claim by the purchaser will have success, as the seller will be in a somewhat weaker position for the duration of any proceedings.

At least initially, the judgment should have limited effect on German law because situations that would be covered by a MAC clause are already covered under the provisions relating to the disruption of the basis of business (*Störung der Geschäftsgrundlage*) in section 313 German Civil Code (*Bürgerliches Gesetzbuch, BGB*). In such cases, the specific wording of the clause will be decisive, as it is in contracts governed by US law.

In light of Brexit, future global economic uncertainties (e.g. the introduction of international duties) and their effect on the finance markets, as well as political uncertainties, we expect MAC clauses to be discussed and negotiated even more intensively in the future – also in Germany.



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## Reform of German stock corporation law: Ministerial draft on the law implementing the second EU Shareholder Rights Directive (ARUG II-RefE)

On 11 October 2018, the German Federal Ministry of Justice and Consumer Protection published a draft bill on the law to implement the second Shareholder Rights Directive (ARUG II-RefE). The Ministerial draft is based on EU Directive (2017/828) of the European Parliament and the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement. The EU Directive must be implemented into German law by 10 June 2019.

The aim of the amending law is to improve shareholder participation rights in stock companies that are listed on the stock exchange, as well as to facilitate the gathering of information and exercise of shareholder rights across borders.

The amendments essentially relate to the identification of shareholders, transparency with respect to institutional investors, transactions of the corporations with related parties and persons and the remuneration policy for company management. Finally, we point out when we can expect the rules to apply.

## Better identification of shareholders (“know your shareholder“)

The Ministerial draft contains rules for simplifying the identification of and information about shareholders. Simplified participation of shareholders guarantees that information will be communicated to and exchanged between companies listed on the stock exchange and their shareholders – even where long chains of intermediaries (e.g. credit institutes, custodian banks) are involved.

The draft reform of section 67d of the German Stock Corporation Act (*Aktiengesetz, AktG*) introduces, for example, a number of obligations on intermediaries regarding the issue, transmission and forwarding of information to stock listed corporations about the identity of shareholders. Corporations that are not listed on the stock exchange can still decide whether they wish to include these information obligations in their articles of incorporation. The obligation to provide and exchange information serves to implement the “know your shareholder” principle, which will apply in the future pursuant to the first sentence of Article 3a para. 1 of the EU Directive. Even if the applicable law for registered shares already contained similar provisions (see section 67 para. 1 second sentence AktG), this right to information constitutes a reform for bearer shares.

## Transparency obligations of institutional investors

The EU Directive also focuses more intensely on the activities of institutional investors, asset managers and consultants on voting rights in the interests of the investors. Various transparency and disclosure obligations with respect to investment behaviour and business models, conflicts of interests and cooperation with other shareholders will therefore be anchored in the German Stock Corporations Act. In addition, this information will be publicly available.

In the future, institutional investors and asset managers will be required to make their participation policy public in accordance with section 134b para. 1-3 of the Ministerial draft, and to provide annual reports on how this policy was implemented. The participation policy should include information about the influence exercised on the portfolio companies, the exchange of information with bodies or stakeholders in the corporation, the exercise of shareholder rights and the handling conflicts of interest.

Institutional investors and asset managers, who decide not to follow these provisions, in whole or in part, must make a statement providing reasons for this decision (“comply or explain”), see section 134b para. 4 of the Ministerial draft. Further, each year a statement must be made pursuant to section 134d para. 1 of

the Ministerial draft, on whether a code of conduct was followed, which provisions were not followed, and which measures were taken instead. If the code of conduct is not followed, an explanation must be provided.

Section 134d para. 4 of the Ministerial draft is significant in practice as it requires voting rights consultants to immediately inform their customers if they have any conflicts of interests and about any counter measures taken in this situation. A conflict of interests could arise, for example, when voting rights consultants also advise companies listed on the stock exchange on corporate governance issues.

## Shareholder participation rights in transactions between the company and related companies or persons (“related-party-transactions“)

Another core element of the Ministerial draft is the participation rights with respect to transactions between the company and related companies or persons. Transparency is increased and free outflows of assets for the benefit of related companies or persons is prevented.

The Ministerial draft grants the supervisory board a veto right over significant transactions. Significant transactions are any that have a commercial value of at least 2.5 % of the total assets as established in the last annual financial statements. This veto right is designed to ensure that any significant transactions occur independent of the interests of related parties. Regardless of the value, transactions will not be considered transactions with related persons when they are carried out in the ordinary course of business and at normal market conditions (first sentence of section 111a para. 2 of the Ministerial draft). Companies must establish internal control procedures, in order to evaluate whether these requirements are fulfilled.

In addition, the conclusion of significant transactions must be made public. This information must be published directly after the conclusion of the contract and is designed to provide shareholders with reliable information without delay.

## Shareholder right to say on the salaries of management and supervisory board members (“say on pay“)

Politically, the most significant element of the Ministerial draft is the amendments in relation to the salaries of corporate bodies (i.e. the executive board and supervisory board) of stock listed companies.

A stronger say for shareholder is ensured through both votes of the general meeting of shareholders on the remuneration package policy for company management and on the remuneration report, which must be published. Neither the EU Directive nor



the Ministerial draft provide any mandatory substantive criteria about the content of remuneration packages; they only establish specifications with respect to transparency and procedures for the establishment of remuneration.

#### **VOTE IN THE GENERAL SHAREHOLDERS MEETING ON REMUNERATION POLICY (SECTION 87A OF THE MINISTERIAL DRAFT)**

In order to improve the right of shareholders to have a say with respect to the corporation's policy on remuneration of corporate bodies ("say on pay"), section 87a of the Ministerial draft introduces the requirement to adopt an advisory resolution of the general meeting of shareholders (see section 120a para. 1 Ministerial draft and section 113 AktG). This resolution must be adopted for every significant change to the policy, or at least every four years. In the future, the "say on pay" will no longer be optional, but mandatory.

The Ministerial draft implements the option contained in the EU Directive and makes the vote of the general shareholders meeting on remuneration policy merely a recommendation (and not binding). This is based on the consideration that a binding resolution would significantly weaken the powers of the supervisory board with respect to remuneration: a consultative vote would therefore be more easily integrated into the German stock corporation law and corporate governance system.

The objective of section 87a of the Ministerial draft is to strengthen the position of shareholders by increasing their influence and control while simultaneously maintaining the strong position of the supervisory board. Greater involvement of shareholders should counteract disproportionately high remuneration for members of the executive board, without affecting the powers of the supervisory board to determine the remuneration of the executive board.

Pursuant to the second and third sentences of section 120a para. 1 of the Ministerial draft, the shareholder resolution on remuneration policy may not be subject to legal challenge; if the recommendation is not followed, the policy must be presented to the general meeting of shareholders once more pursuant to section 120a para. 3 of the Ministerial draft.

#### **VOTE OF THE GENERAL MEETING OF SHAREHOLDERS ON THE REMUNERATION REPORT (SECTION 162 OF THE MINISTERIAL DRAFT)**

Pursuant to section 162 of the Ministerial draft, the executive and supervisory boards of stock listed companies must prepare a detailed report on the remuneration paid or due to current or former members of the executive board and the supervisory board.

The report is to be individualised and must name the board members; there is no possibility to "opt-out" of being named. It must be published annually in a form that can be easily understood and must contain all fixed and variable elements of the remuneration package. In addition, it must also set out the extent to which the persons named in the remuneration report meet the criteria of the remuneration policy. Further, a comparison must be made between the remuneration paid to the board and to the average

level of remuneration of employees ("manager to worker pay ratio") over the past five business years. The report must also outline the extent to which the possibility to reclaim variable remuneration ("clawbacks") has been exercised.

#### **FIRST APPLICATION OF THE RULES**

The Ministerial draft contains various transitional rules in Article 2. According to this provision, a resolution of shareholders about the remuneration policy for the executive and the supervisory board members will first need to be adopted by a general meeting of shareholders held four months after the implementing law enters into force (where the law enters into force in June 2019, it would only apply for general meetings of shareholders held in or after November 2019). The same applies to certain aspects of the new remuneration report. The rules on the identification of shareholders and the exchange of information with shareholders only apply to a shareholder meeting held one year after the law enters into force (foreseeably, therefore, a general meeting of shareholders held in 2020).

## Summary

The adoption of the Second EU Directive on Shareholder Rights means a number of new features for German stock corporation law, particularly with respects to remuneration, related party transactions, and the identification of and information about shareholders. In so doing, the legislator is attempting to fit the requirements of the EU Directive into the existing German legal structure. Increased transparency with respect to remuneration and related party transactions will significantly strengthen the German corporate governance framework, while the approval of the supervisory board on related party transactions is an interesting new feature in the interplay between the corporate bodies of a stock corporation.



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## EU Money Laundering Directive enters into force

While the amended German Money Laundering Law (*Geldwäschegesetz, GwG*) based on the 4th EU Money Laundering Directive (EU Directive 2015/849) only entered into force with effect from 26 June 2017, German legislators already need to make further changes to it. Instead of resting on their laurels, EU institutions published the 5th EU Money Laundering Directive on 19 June 2018, concluding the EU legislative process. The Member States now have until 10 January 2020 to transform the new Directive into national law. In contrast to the 4th EU Money Laundering Directive, which introduced a complete new framework for the money laundering provisions, the 5th EU Money Laundering Directive only makes selected amendments to its predecessor and extends its area of application. In our [September briefing](#) we explained the effects that the new 5th EU Money Laundering Directive will have on the transparency register; here we focus on the other significant new features.

### Significant new features

An amendment to Article 2 para. 4 of the 4th EU Money Laundering Directive extends the group of persons, who are subject to the obligations of the Directive. In addition to adding any persons that provide “*material aid, assistance or advice on tax matters a principal business or professional activity*” to the list of “*auditors, external accountants and tax advisors,*” the scope now also extends to real estate agents and intermediaries for the trade in works of art. These amendments should be viewed as cosmetic corrections to the 4th EU Money Laundering Directive, which had left some gaps in the group of persons to which the Directive applied.

### COVERAGE EXTENDED TO VIRTUAL CURRENCIES

One of the most significant changes to the Directive is the inclusion in Article 2 of “*providers engaged in exchange services between virtual currencies and fiat currencies*” and “*custodian wallet providers*” in the group of persons with obligations under the Directive. This change extends the application of the Directive to the market for virtual currencies like Bitcoin and Ripple. As the Directive now applies to operators of virtual platforms for the trade in virtual currencies and to providers of virtual wallets, the identification of users of virtual currencies can now be ensured. The European legislators hope that this will further limit the potential risks and dangers associated with anonymity in the area of cryptocurrencies, minimising criminal potential in this area.

### DUE DILIGENCE OBLIGATIONS FOR “HIGH-RISK COUNTRIES”

The 5th EU Money Laundering Directive aims to further harmonise the strengthened due diligence obligations where the natural or legal persons involved are located in so-called high-risk countries. The 4th EU Money Laundering Directive failed to establish the specific due diligence obligations that had to be observed in such cases. The 5th EU Money Laundering Directive rectifies this, providing a binding list of minimum requirements, which must be ob-

served when the customer comes from a high-risk country. These include the obligations to obtain additional information about the customer and their beneficial owners, to establish the intended nature of the business relationship and the source of funds, to determine the reasons for the planned transaction, to obtain the approval of senior management before continuing the business relationship and to conduct increased monitoring of the business relationship. In addition, where the transaction involves high-risk countries, there is an additional due diligence obligation to minimise money laundering risks.

### REPORTING

The 5th EU Money Laundering Directive also significantly extends the reporting requirements. In the future, it should be possible to identify all national bank accounts belonging to a person which should make it easier for the authorities to establish the identity of persons authorised to access bank accounts. This is complemented by a longer period of retention, which requires all data to be kept for five to ten years after the end of the business relationship. In addition, the national transparency registers will become better networked with one another. In this respect it is important that the requirements for access to information from the transparency register are loosened (see § 20 para. 1 GwG). Until now it has only been possible to access the register where a legitimate interest in the relevant entry could be established. In the future, this legitimate interest will no longer be required. Instead, “all members of the public” will be able to access the register.

### Implementation and practical consequences

The Directive must be implemented by 10 January 2020. Some of the requirements established in the 5th EU Money Laundering Directive were already implemented into the GwG as part of the transposition of the 4th EU Money Laundering Directive. It is therefore not necessary to completely revise the German law. Still, some specific elements will have to be adjusted, such as the elements related to the trade in cryptocurrencies. It is not yet clear when the German legislators will take another look at the GwG. However, as there is less than one and a half year left before the deadline to transpose the Directive, it is recommended that you use the time to assess whether additional changes need to be made within your organisation in order ensure compliance with the requirements of the 5th EU Money Laundering Directive. You should make the new requirements an integral part of the internal compliance management systems of each of your companies. This is also advisable because there is likely to be a further strengthening of the legal provisions regarding money laundering in the future.



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## Changes to various energy laws

On 30 November 2018, the German Federal Parliament (*Bundestag*) adopted the “Law on the Amendment of the Renewable Energy Sources Act, the Combined Heat and Power Act, the Energy Industry Act and other energy law provisions” – also known as the Collective Energy Act (see Documents of the German Federal Parliament (*Bundestags-Drucksache*) 19/5523 and 19/6155) and on 14 December the German Federal Council (*Bundesrat*) passes the law during its last sitting of the year. The act will enter now into force once it has been published in the German Federal Gazette (*Bundesgesetzblatt*). It should be noted, however, that some provisions will apply retroactively from 1 January 2017 or 1 January 2018, while others will only take effect from 1 August 2019 (see Article 15 of the Collective Energy Act).

The original impetus for the law was the fact that end of 2017 the European Commission ceased to view renewable energy levy reductions, which were granted for energy generated by cogeneration heat and power plants for self-supply, as compatible with state aid law. The agreement afterwards reached between the German Federal Government and the European Commission for certain cogeneration heat and power plants had to be implemented into German law as soon as possible. However, as the parties within the Government were unable to reach an agreement on various other issues, there had been delays in adopting the law – and it became increasingly complex and much broader in scope. The result now is that most of the energy acts will be amended: the Renewable Energy Sources Act 2017 (*Erneuerbare-Energien-Gesetz 2017*), the Combined Heat and Power Act (*Kraft-Wärme-Kopplungsgesetz*), the Energy Industry Act (*Energiewirtschaftsgesetz*), the Environmental-Access to Justice Act (*Umwelt-Rechtsbehelfsgesetz*), the Electricity Grid Charges Regulation (*Stromnetzentgeltverordnung*), the Low Voltage Connection Regulation (*Niederspannungsanschlussverordnung*) the Low Pressure Connection Regulation (*Niederdruckanschlussverordnung*), the Renewable Energy Regulation (*Erneuerbare-Energien-Verordnung*), the Regulation on Collective Tenders for Onshore Wind Energy Installations and Solar Energy Installations (*Verordnung zu den gemeinsamen Ausschreibungen für Windenergieanlagen an Land und Solaranlagen*), the Regulation on the Tender for Cogeneration Heat and Power Plants (*KWK-Ausschreibungsverordnung*), the Act on Offshore Wind Energy Installations (*Windenergie-auf-See-Gesetz*), the Offshore Installations Act (*Seeanlagengesetz*), the Regulation on Air Navigation Equipment for Aircraft (*Verordnung über die Flugsicherungs-ausrüstung der Luftfahrzeuge*) and the Network Charge Modernisation Act (*Netzentgeltmodernisierungsgesetz*).

Here is an overview of the main amendments.

### Renewable Energy Sources Act 2017

Operators of onshore wind power installations which are required to have night identification under air traffic law must now ensure that their wind farms are fitted with on-demand obstacle lighting for air traffic from 1 July 2020. The same applies to operators of offshore wind farms when the plant is located in German territorial

waters, in Zone 1 of the German Exclusive Economic Zone in the North Sea or in the German Exclusive Economic Zone in the Baltic Sea (see section 9 para. 8 Renewable Energy Sources Act 2017, new).

For onshore wind farms, tender quantities are reduced for 2019 to 2021. However, specific invitations to tender must be carried out during this period, with a tendered volume of three times 500 MW of installed capacity in 2019, two times 300 MW and two times 400 MW in 2020 and four times 400 MW in 2021 (section 28 para. 1 Renewable Energy Sources Act 2017, new).

This also applies to solar plants. The tender quantities for specific invitations to tender are almost identical to those for onshore wind farms: tendered volumes of two times 500 MW in 2019, two times 300 MW and two times 400 MW in 2020 and four times 400 MW of installed capacity (section 28 para. 2 Renewable Energy Sources Act 2017, new).

The reference values applicable to the payment for electricity from solar power installations on or in a building or noise protection wall with an installed capacity of up to 750 KW will be reduced to 9.87 cent per kWh from 1 February 2019, to 9.39 cent per kWh from 1 March 2019 and to 8.90 cent per kWh from 1 April 2019 (see section 48 para. 2 Renewable Energy Sources Act 2017, new).

The Collective Energy Act introduces new and more differentiated reduced renewable energy levies for electricity from cogeneration heat and power plants for own use. Cogeneration heat and power plants with an installed capacity of between 1 and 10 MW will no longer be able to reduce their renewable energy levies to 40% when the capacity utilisation exceeds 3,500 full hours for self-supply. The reduction will then also not apply for the first 3,500 full hours of usage for self-supply to the degree that installation utilisation exceeds 3,500 full hours for self-supply in a calendar year. However, there is an exception to the full renewable energy levy where the operator of a cogeneration heat and power installation is active in one of the sectors listed in Annex 4 List 1 of the Renewable Energy Sources Act 2017.

For electricity produced via a new cogeneration heat and power installation, the renewable energy levy is reduced to 40 % for the first 3,500 full hours of usage when:

- The electricity is consumed after 31 December 2017 and before 1 January 2019 and the plant is used by the end consumer for the first time for self-supply after 31 July 2014 but before 1 January 2018.
- The electricity is consumed after 31 December 2018 and before 1 January 2020 and the plant is used by the end consumer for the first time for self-supply after 31 December 2015 but before 1 January 2018.
- The electricity is consumed after 31 December 2019 and before 1 January 2021 and the plant is used by the end consumer for the first time for self-supply after 31 December 2016 but before 1 January 2018 (see sections 61c and 61d Renewable Energy Sources Act 2017, new).

A new element provides exceptions to the requirement to separate (self-supply) electricity via equipment that conforms to measurement and calibration laws. This affects the following cases:

- The highest renewable energy levy applicable to part of this electricity volume will be applied to the entire electricity volume.
- Where the separation is technically impossible or is only possible with an unreasonable expense, and calculations based on the above bullet point cannot be considered economically reasonable (section 62b Renewable Energy Sources Act 2017, new)

Sections 104 para. 10 and para. 11 Renewable Energy Sources Act 2017, new contain transitional arrangements on this issue.

The rules described here and with respect to the Collective Energy Act above both enter into force retroactively from 1 January 2018.

## Combined Heat and Power Act

The Collective Energy Act extends the application of the Combined Heat and Power Act by three years – to the end of 2025 instead of the end of 2022. This affects aid both for cogeneration heat and power plants and for heating and cooling networks and -storage (see sections 6 para. 1, 18 para. 1 and 22 para. 1 Combined Heat and Power Act, new). Of course, such grants are still subject to approval under state aid law.

Because of the broad understanding of the term installation also steam condensate cogeneration heat and power plants will now be eligible for aid, see sections 6 para. 1a and 7 para. 2a Combined Heat and Power Act, new. As steam condensate cogeneration heat and power plants regularly contain numerous steam generators, such installations no longer fulfilled the requirements of power generation based on waste, waste heat, organic matter or liquid or gaseous fuel. Section 35 para. 16 of the new Combined Heat and Power Act contains transition rules on this issue.

In addition, the amended Combined Heat and Power Act contains rules on the measurement and estimate regarding the cogeneration heat and power levies. The legislators chose not to create a new rule, but referred instead to the rule already set out in Sections 62a, 62b and 104 para. 10 and para. 11 of the amended Renewable Energy Sources Act (see Section 26c Combined Heat and Power Act, new). This amendment enters into force retroactively from 1 January 2018.

## Energy Industry Act

The formation of capacity reserves is postponed for two years until 2020/2021. Consequently, the relevant tender proceedings are also postponed and will be held in 2019 rather than 2017 (Section 13e para. 1 and para. 2 Energy Industry Act). Capacity reserves create a capacity puffer from generation plants, storage and variable loads, which are not active on the electricity market. This is a further tool that can be used to ensure system balance in exceptional and unforeseen circumstances.

As is already the case for the Combined Heat and Power Act, Sections 62a, 62b and 104 para. 10 and para. 11 of the new Renewable Energy Sources Act apply regarding the offshore liability levy (*Haftungsumlage*). Consequently, these provisions also enter into force retroactively from 1 January 2018.

In addition, the Act introduces a transitional rule for network connection from energy generation installations, which were planned on the basis of the current technical grid connection requirements, but which now fall under the scope of the Network Code on Requirements for Generators (RfG). Upgrades to such installations should be avoided unless they are necessary for security of supply (Section 118 para. 25 of the Energy Industry Act new).

## Offshore Wind Energy Installation Act

The Offshore Wind Energy Installation Act is extended to cover offshore wind energy installations that are not connected to the network and “other power generation facilities”. These include, for example, hydroelectric power facilities, but also power generation from other sources such as gas, or other energy forms such as thermal energy. Offshore wind energy installations, which are not connected to the grid, may not take part in a tender procedure. Such installations are designed for direct use of the energy offshore, such as to operate an electrolysis system to produce hydrogen.



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## New developments in paid leave law

On 6 November 2018, the European Court of Justice (ECJ) handed down judgments in various cases before it, which will have a significant influence on the German law on paid leave. The case concerned the question of whether an employee can demand payment in lieu of leave that has not been taken by the end of an employment relationship, even if the employee failed to apply for leave (Joined cases C-619/16 and C-684/16). With decisions of the same day, the ECJ held that the heirs of a deceased employee can demand payment in lieu of leave not taken by the deceased from the deceased's employer (Joined cases C-569/16 and C-570/16).

### Payment in lieu of leave: Employers must encourage employees to take leave in good time

The first case concerned claims made by two employees for payment in lieu of leave that they had not taken before the end of



their employment relationships (leave compensation). One of the employees was completing part of his legal training with a public employer, while the other had worked for many years for the Max Planck Society, a private employer. Their claims had been dismissed at the first instance because they had failed to apply for leave.

The ECJ held that the employee would not lose the right to claim payment in lieu for any leave not taken simply because they failed to apply for the leave before the end of the employment relationship. Instead, the claim would only be forfeited if the employer adequately informed the employee of their right to take leave and gave the employee the opportunity to take the leave in good time. The ECJ held that the disparate positions of power between the parties to the employment contract meant that the employee could not be expected to assert his or her rights. The assessment in the case would be different if the employee had freely chosen to go without annual leave.

#### **PRACTICAL TIP**

The new requirements apply to both public and private employers. If an employment relationship is about to end and claims to payment in lieu of leave are to be avoided, the employer must encourage the employee to apply for their remaining leave in good time. At the same time, the consequences of not taking the leave – that it will lapse – should be made clear to the employee. In the case of a dispute, employers have the burden of proving that they have fulfilled their duties to provide information and have put the employees in the position that would actually allow them to take their leave. The German Federal Labour Court (*Bundesarbeitsgericht, BAG*) may decide to apply these same basic principles to the issue of forfeiture of leave in existing employment relationships. Accordingly, it can no longer be assumed that leave will be automatically forfeited at the end of the year or the end of the leave transfer period. To be certain, employers should therefore inform all employees in good time before the end of the leave year of the number of leave days that they have remaining, request that the employees take their remaining leave and inform them of the fact that they risk forfeiting their leave should they fail to take it. If practical, a rule should be implemented, which requires employees to specify at the start of each year when they intend to take the majority of their leave during that year.

## **ECJ affirms payment in lieu of leave not taken by deceased employees**

The second reference for a preliminary ruling concerned two widows, who sought payment in lieu of the leave not taken by their deceased husbands. In numerous judgments, the BAG has held that the employee's claim of leave cannot be converted into a claim for payment in lieu under section 7 para. 4 of the German Federal Leave Act (*Bundesurlaubsgesetz, BUrlG*) where the employment relationship ends with the death of the employee. According to this provision, payment is to be made in lieu of the

leave when all or some of the leave cannot be used due to the employment relationship coming to an end. Upon the death of the employee, however, the purpose of the leave cannot be achieved, so that the claim to leave is extinguished and, according to the BAG, cannot therefore become part of the estate. The BAG only recognises that heirs have a right to payment in lieu of leave not taken by the deceased when the deceased had already become entitled to this right to payment in lieu during his or her lifetime, i.e. when the employment relationship ended prior to the death and the remaining entitlements to leave had been converted into a right to payment in lieu.

The ECJ confirmed its earlier jurisprudence that an employee's entitlement to paid leave is not lost with the death and may therefore be inherited (Judgment of the ECJ of 12 June 2014 in Case C-118/13). In addition, the ECJ made it clear in response to the preliminary questions from the BAG that this would be the case, even if German inheritance rules prevented such financial compensation from being part of the estate. The heirs could demand payment in lieu of the leave not taken, regardless of whether the employment relationship still existed until the time of death or whether a right to payment in lieu arose because the employment relationship had ended prior to the death. The purpose of leave also has a financial component, which is a claim purely under property law and does not lapse with death. This right also cannot be revoked retroactively by death. Consequently, this claim under property law, which was acquired by the employee, must be transferred to his or her heirs. National law, which prevents this from happening, would be contrary to EU law.

With this judgment, the ECJ contradicts the jurisprudence of the BAG and once again interferes extensively in the national German case law and the German legal system. The judgment of the ECJ has made the earlier BAG jurisprudence obsolete. The right to payment in lieu no longer depends on the time of death; that means the claim to leave compensation is given whether it arose before the decease of the employee or not. Accordingly, the BAG is has to choose between applying the German succession law rules, which do not award the financial payment in lieu to the estate, or interpreting the national provisions so that they are in line with the EU law provisions.

#### **PRACTICAL TIP**

Payroll and HR departments can expect to receive greater numbers of claims from heirs for payments in lieu of leave in the future. When assessing whether these claim are justified, don't forget the existing time limits, which may have already barred any obligation to make the payment.

## **Summary**

EU law already had a strong influence over the German law on leave, not least due to the fact that the ECJ had already changed the existing BAG jurisprudence on many occasions with an interpretation under EU law which contradicted the German



approach. These new judgments of the ECJ further increase the requirements on employers. The ECJ view of the purpose of leave under EU law has been systematically maintained. Accordingly, leave is not only designed to maintain and restore health and an employee's fitness for work, but is also an opportunity for employees to engage in recreational activities of their own choosing, which entails a financial aspect. It is important to note, however, that the new principles only apply to statutory leave. Diverging arrangements can and should continue to apply to the extent possible to any additional leave agreed in an employment contract.



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## Streaming of games

Many consider cloud gaming the next step for the games industry. In the future, players will no longer need expensive hardware to play the latest games with high resolution graphics, but can experience the game entirely on the internet via so-called streaming boxes. Spotify and Apple Music have led the way for the music industry; Netflix and Amazon Prime have done the same for the film and television industry.

As always, changes to business models give rise to new legal issues. The streaming of games will first affect the drafting of contracts. On the one hand, this is due to the fact that streaming is different from previous forms of distribution, e.g. in physical form on discs or other storage mediums or in digital form as downloads. Therefore, such technology will, for example, have effects on licensing agreements. In this context, games providers should ensure that all their content is sufficiently licensed. Even if the contracts are fine from a US law perspective or under English law, they should be reviewed under German law as well: German copyright law is notoriously difficult when it comes to new technological developments.

On the other hand, streaming technologies will also lead to different business models such as, for instance, subscription models instead of individual purchases, and, accordingly, other contractual relationships with players will be required (long-term contracts instead of individual purchase contracts). This may raise issues with regard to players' support, for example if game providers decide to discontinue certain services.

Streaming will also allow providers to precisely record and document game actions performed by players, in order to obtain information on user behaviour and user preferences. This will raise issues in relation to data protection law.

As providers can use information, algorithms and artificial intelli-

gence to adapt their gaming offer to players, streaming technologies will continue to develop. It is therefore important to monitor all legal questions and issues as they arise.



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We advise on all corporate, labour and tax law issues, and on EU law. We assist, for example, with the conclusion of partnerships and strengthen and support companies when planning market entry and during all phases of their business.

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