FORUM JURIS

03/2011

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Law coming to you.

Ladies and Gentlemen,
Dear Clients,

We are pleased to provide you with the third issue of our *Forum Juris* Newsletter in 2011 which deals with the following current legal topics and latest developments in legislation and court decisions:

A due diligence investigation is an indispensable component of a corporate acquisition. It is not generally met with resistance if all the shares in a company are sold or the target company is held by one shareholder only. It can be different, however, if the aim of the transaction is only to hold a minority interest. The first article of this edition sheds light on the problems which can be the result of such an arrangement.

Further, we would like to present the corporate bond as a financing alternative to you. The corporate bond as an instrument to obtain capital from outside sources can be an attractive financing possibility particularly for medium-sized enterprises. As a capital market partner for the stock exchange in Dusseldorf Raupach assists you in preparing the Initial Bond offering (IBO).

Members of the board of management transferring to the supervisory board of listed stock corporations are always good for making the headlines. One of our articles elucidates the cooling off period of two years for a transfer from the board of management to the supervisory board and gives details of the exemptions.

Further topics of this issue are:

- Foreign notarization now possible without hesitation following a decision by the Higher Regional Court in Dusseldorf?
- Comfort Letter – Federal Court of Justice provides further legal certainty
- "Whistleblowing" as Reason for Dismissal – Decision by European Court of Human Rights

Our *Corporate* Service Line is described to you in our "*Internal Raupach News*" rubric of this edition.

We hope that the aforementioned topics arouse your interest. Should you have any questions on the individual articles in this edition or indeed any other suggestions for our *Forum Juris* Newsletter, please do not hesitate to get in touch with the editors or your contact persons.

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Managing Director's Obligation to Present the Audited Annual Statements

Pursuant to § 42 Subsections 1 and 2 German Limited Liability Law (*GmbH-Gesetz – GmbHG*) the managing director must insure that the audited annual statements are presented for final adoption to the shareholders within the period provided for in § 42 Subsection 2 GmbHG. The managing director commits a serious breach of his/her duties if he/she neglects to do this which in turn constitutes good cause for revoking the managing director's appointment. A simple majority in the shareholder meeting suffices to revoke the managing director's appointment with good cause in order to comply with the compulsory rule in § 38 Subsection 2 GmbHG. Contradictory regulations in the articles of association are ineffective.
Source: Superior Court of Justice (Kammergericht – KG) in Berlin dated August 11, 2011; Case No. 23 U 114/11

Shareholder Meeting Approval Required for Termination of a Domination Agreement by the Dominated Limited Liability Company. The dominating enterprise is permitted to vote regarding the corresponding resolution.

As dominated company, the defendant limited liability company (*Gesellschaft mit beschränkter Haftung – GmbH*) concluded a domination and profit and loss transfer agreement with its majority shareholder in 1999. The plaintiff is the GmbH's minority shareholder. In the GmbH's shareholder meeting on November 22, 2007, it proposed a resolution on an ordinary termination of the domination and profit and loss transfer agreement for the next possible date. The proposal was rejected with the majority shareholder's votes. The ultimately unsuccessful legal action was directed at this aspect.

A majority decision was not made in the shareholder meeting on the ordinary termination of the domination and profit and loss transfer agreement. The majority shareholder's votes must be counted since it was permitted to vote. Pursuant to § 47 Subsection 4 Sentence 2 GmbHG a shareholder does not have a right to vote regarding a resolution which concerns a legal transaction with it. Excluded from this prohibition to vote, however, are corporate social acts which affect the company's internal affairs and where the shareholder exercises its right of membership. In these cases a prohibition to vote cannot already apply when the content of the resolution also affects the personal sphere of the shareholder concerned. The resolution on the ordinary termination of a domination and profit and loss transfer agreement vis-à-vis the dominating shareholder not only affects the relationship of the dependent company with its dominating shareholder but also the company's internal affairs and modifies its organizational structure so that the dominating shareholder cannot be denied its involvement. Just like its conclusion the termination of the corporate agreement has both effects regarding the law of obligations and legal organizational effects. The termination is therefore not a management measure which is assigned to the managing directors of a GmbH.
Source: NJW Spezial (Neue Juristische Wochenschrift Spezial – new legal weekly magazine special), Federal Court of Justice (Bundesgerichtshof – BGH) Ruling dated May 31, 2011 – Case No. II ZR 109/10

Assessment of Payment of Share Capital by the Commercial Register.

The Commercial Register must only assess the fulfillment of the minimum statutory obligations to pay the share capital even if there are tighter regulations on the payment obligations of the shareholders in the articles of association of a limited liability company to be established.

The applicants applied to the Commercial Register for the establishment of a Limited Liability Company (*Gesellschaft mit beschränkter Haftung – GmbH*) to be entered in the Commercial Register. The application also included the assurance pursuant to § 8 Subsection 2 German Limited Liability Law (*GmbH-Gesetz – GmbHG*) that the minimum share capital which is stipulated by law had been paid and was at the managing directors' free and final disposal. It was regulated in the GmbH's articles of association that "the shares must be paid in full without undue delay. The Commercial Register rejected entry in the Commercial Register on the grounds that the regulations in the articles of association had to be modified before entry in the Commercial Register so that the amount which had actually been paid corresponded to the minimum share capital.

The Higher Regional Court (*Oberlandesgericht – OLG*) in Stuttgart allowed the appeal directed at this aspect. The assessment of the Commercial Register pursuant to § 9c GmbHG for the entry of a GmbH must be limited to the minimum statutory requirements. The Commercial Register does not have to assess whether a tighter rule going beyond the statutory requirements is regulated in the articles of association nor reject entry in the Commercial Register if the obligations specified in the articles of association are not fulfilled.
Source: Higher Regional Court (Oberlandesgericht – OLG) in Stuttgart Ruling dated July 13, 2011 – Case No. 8 W 252/11, Beck-Rechtsprechung (Beck Periodical of Court Decisions) 2011, BECKRECHTSPRECHUNG year 19282

No Prohibition to Vote in a One-Man Stock Corporation.

In the company's annual general meeting the sole shareholder is not subject to a prohibition to vote pursuant to § 136 Subsection 1 German Stock Corporation Act since its interests do not clash with the other shareholders.

In June 2007 the Annual General Meeting (AGM) of HypoVereinsbank AG (hereinafter also referred to as "HVB") appointed a special representative pursuant to § 147 Subsection 2 German Stock Corporation Act (*Aktiengesetz – AktG*) who was to assert alleged compensation claims by HVB vis à-vis its former majority and current sole shareholder UniCredit S.p.A. (hereinafter also referred to as "UniCredit"). Following a squeeze-out which had been entered in the Commercial Register in the meantime the sole shareholder UniCredit resolved to revoke the special representative again in an extraordinary AGM of HVB in November 2008. The special representative filed legal action for contestation regarding this resolution. The court of appeal dismissed the legal action after the Regional Court (*Landgericht* – LG) had allowed it. The special representative's appeal against denial of leave to appeal was not successful.

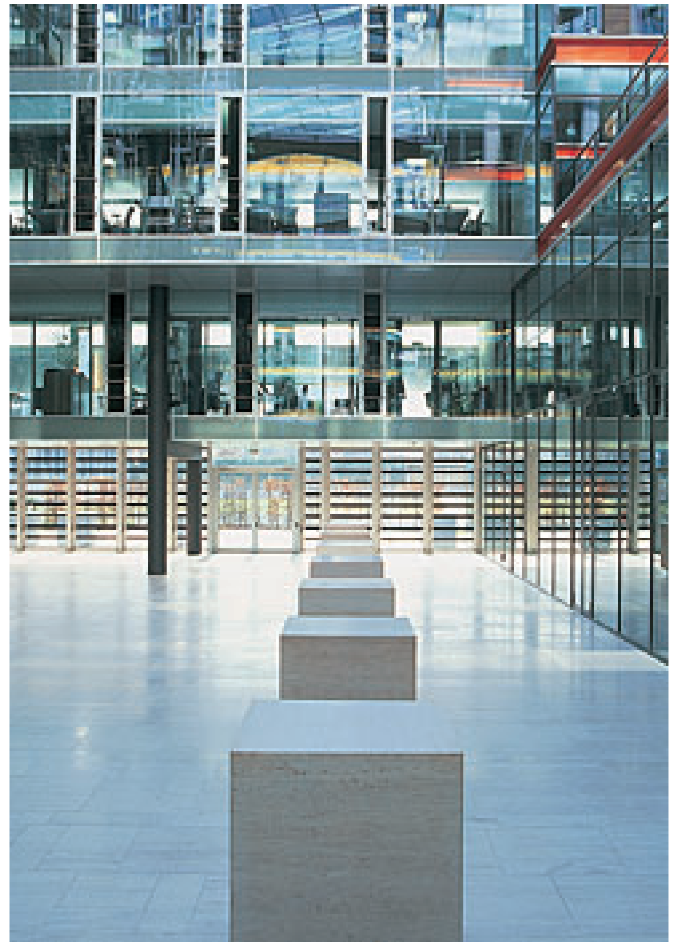
At the center of the legal dispute is the issue whether § 136 Subsection 1 AktG imposes a prohibition to vote on the sole shareholder UniCredit. Among other things, the regulation excludes a shareholder from exercising its right to vote when a resolution is made on whether the company should assert a claim against the shareholder. The decision on the appointment or revocation of a special representative is also generally included here if the special representative is to proceed against the shareholder concerned (here: UniCredit). The question is posed in the instant case whether § 136 Subsection 1 AktG is to be reduced in its sense and purpose to the fact that the prohibition to vote does not apply to a sole shareholder. The Federal Court of Justice (*Bundesgerichtshof – BGH*) does not believe this issue needs clarification. In accordance with its decisions on § 47 Subsection 4 GmbHG regarding one man limited liability companies (*Gesellschaft mit beschränkter Haftung – GmbH*) the BGH is of the opinion that this regulation only serves to protect the company assets vis-à-vis individual shareholders and works in the favor of all shareholders rather than in the favor of the company's creditors. A prohibition to vote is thus generally excluded in a one-man GmbH since such a clash of interests just does not exist. Only the same could apply to a one-man stock corporation (*Aktiengesellschaft – AG*).
Source: BGH Ruling dated July 12, 2011 – Case No. II ZR 58/10, Beck Rechtsprechung (Beck Periodical of Court Decisions) 2011, BECKRECHTSPRECHUNG year 19374

No Termination of Agreement Through Accrual

If a general partnership is active as a commercial agent and if its assets are transferred to the last remaining shareholder by means of accrual (*Anwachsung*, collapse merger), this does not lead to an automatic termination of the commercial agent agreement nor is the other contractual partner entitled to make an extraordinary termination.

As a commercial agent, a general partnership (*Offene Handelsgesellschaft – oHG*) concluded a commercial agent agreement with the defendant in 2001. The interests held in the oHG by Messrs. H and M were acquired by the plaintiff, a limited liability company (*Gesellschaft mit beschränkter Haftung – GmbH*), in 2008 and/or the beginning of 2009 so that an accrual (Anwachsung) came about for the plaintiff as a result of the amalgamation of shares. The plaintiff then informed the defendant that the commercial agent agreement continued to exist as before. The defendant contradicted this with correspondence dated June 15, 2009. On September 30, 2009, the defendant requested the plaintiff to conduct no further activities as its commercial agent. The plaintiff replied that it considered the correspondence to be an ordinary termination of the agreement with due notice and now asserted a compensatory claim for loss of clientele pursuant to § 89b German Commercial Code (*Handelsgesetzbuch – HGB*) in the amount of just under EURO 180,000. The Regional Court (*Landgericht – LG*) and Higher Regional Court (*Oberlandesgericht – OLG*) allowed the legal action.

The oHG's assets were transferred to the plaintiff by means of accrual (*Anwachsung*) through the plaintiff acquiring all the oHG shares. This also covered the commercial agent agreement with the defendant. The defendant did not obtain a right to extraordinary termination through the transfer of the commercial agent agreement. A precondition for a termination for good cause would have been that cooperation with the plaintiff would have been disrupted for the defendant due to loss of confidence to such a degree that the defendant could not be expected to wait until the end of the ordinary notice period (six months). The defendant's correspondence was not therefore viewed as an extraordinary termination and did not result in terminating the commercial agent agreement without notice since good cause was lacking. The court was of the opinion, however, that the correspondence constituted ordinary termination so that there was a compensatory claim for loss of clientele pursuant to § 89b HGB.



Source: Higher Regional Court (Oberlandesgericht – OLG) in Stuttgart, Ruling dated May 30, 2011 – Case No. 5 U 189/10, Beck Rechtsprechung (Beck Periodical of Court Decisions) 2011, BECKRECHTSPRECHUNG year 16755

Co-Shareholders Refuse to Contribute to Due Diligence Preparing for the Selling Process

Today, due diligence examinations are carried out prior to most acquisitions. This applies to the acquisition of shares ("share deal") as well as to the acquisition of a major part or all of the assets ("asset deal") of a company. In the course of due diligence, the buyer of the company is provided with detailed and comprehensive information about the company in preparation for the acquisition. After this analysis of the operating and business data, the impairment of the company as well as potential risks will be assessed and incorporated into the purchase price offer by the acquirer.

If the target enterprise is a company with several shareholders, no problems will arise, provided that all shareholders are in agreement about initiating a selling process. There will be legal issues, however, if only some of the shareholders wish to sell possibly even just their minority shares in the target company to a third party. Due to the fact that even in the event of an acquisition of minority shares, a potential acquirer usually wishes to carry out at least a limited due diligence, the question of the management's and remaining shareholders' duty to contribute to the preparation and carrying out of such due diligence process arises.

Generally, all shareholders (even minority shareholders) have a right to be given information in accordance with § 51a GmbHG (*German Limited Liability Companies Act*). Accordingly, the managing director is obliged to immediately inform any shareholder about any affairs of the company and to provide access to such company documents to the respective shareholder upon request. The management can deny this shareholder's right of information only where it is feared that the requesting shareholder will use this information for purposes not related to the company and that this will cause significant disadvantages for the company. Denial, however, is always subject to the resolution of the shareholders. In addition, the management of the target company is subject to obligations to maintain secrecy which apply particularly when a competitor wishes to acquire shares in the target company.

This tension between the management's confidentiality obligations and the individual shareholders' wishes to carry out a due diligence process by a potential acquirer can be mitigated by a resolution adopted by the shareholders. If all shareholders are in agreement regardless of whether they wish to participate in the selling process or not, the implementation of a due diligence process can be resolved by a corresponding unanimous resolution adopted by the shareholders and the management can be instructed accordingly to prepare and carry out this process.

Problems will arise, however, if the shareholders disagree with respect to initiating a selling process. Due to the fact that it is often assumed that the shareholders willing to sell are not entitled to vote in the ballot in case of a resolution adopted by the shareholders, the meeting of shareholders can object the carrying out of the due diligence process. Normally, this results unavoidably in termination of the transaction and can cause serious disadvantages for the shareholders willing to sell.

To avoid this unfavorable situation, provisions for carrying out such a process should be agreed upon in the articles of association between the individual shareholders of the target company in good time. Articles of association often contain detailed mechanisms about preemptive rights of the shareholders not involved in the sale, about tag-along rights, as well as other provisions that have to be taken into consideration when shares are sold.

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Often, however, the aforementioned contribution to a due diligence process prior to the sale is not or only insufficiently implemented so that the shareholders willing to sell might only be able to force the management's or the remaining shareholders' contribution to such a due diligence process by initiating time-consuming legal proceedings with an unpredictable result. This can be a significant impediment in a selling process and should therefore be set out in the articles of association beforehand.

If the duties of the shareholders not willing to sell have not been set out in an agreement between the shareholders, the other shareholders can encounter significant difficulties already while carrying out a due diligence process. In this respect, the shareholders should adopt provisions beforehand in order not to jeopardize a possible selling process.

Rechtsanwalt Peter Homberg and
Rechtsanwältin Dr. Stefanie Greifeneder, Frankfurt am Main

Foreign Notarization Now Possible Without Hesitation Following a Decision by the Higher Regional Court in Dusseldorf?

Notarization in corporate law, particularly in connection with transferring shares in a limited liability company (*Gesellschaft mit beschränkter Haftung – GmbH*), during corporate transactions is often undertaken by notaries public in Switzerland when there are purchase prices involving seven digits. The reason for this is the unrestricted negotiability of the fees for the Swiss notaries public compared with the fixed fee schedule in Germany which it is compulsory for the German notaries public to follow. The transaction costs can thus frequently be reduced significantly by carrying out the notarization in Switzerland despite a maximum limit of EURO 60 million applying to the value of notarization procedures in Germany. This virtually led to notarization tourism in the past.

I. Equivalence to German Notarization

The center of the discussions in corporate law is, however, the strongly controversial issue of whether foreign notarization would meet the German requirements that notarization is compulsory when shares are transferred (*§ 15 Subsections 3 and 4 German Limited Liability Companies Law* (*GmbH-Gesetz – GmbHG*)) or whether such share transfers should instead be reserved for German notaries public. The high-court decisions favored the previous legislation, i.e. the legal situation before the Act to Modernize Limited Liability Company Law and to Combat Abuse (*Gesetz zur Modernisierung des GmbH Rechts und zur Bekämpfung von Missbräuchen – MoMiG*) took effect in November 2008, where the form of notarization in German law was fulfilled by foreign notarization if it was equivalent to German notarization. Both the position and function of the authenticating person as well as the act of notarization and certification must generally correspond to the conditions stated in German law; however, it does not need to be absolutely identical.

However, such equivalence has only been hitherto assumed in high-court decisions on individual cases for notarization by notaries public in a small number of Swiss cantons: the City of Basel, Zug and Zurich. Legal literature states that this also applies to notarization in Austria, for example. However, the American *notary public* or the Danish *Notarial Kontoret* do not enjoy the same equivalence.

Following the reform of GmbHG in 2008 doubt was initially expressed in legal literature as to whether foreign notarization could still be maintained at the previously sustained level against the background of the obligations associated with notarization (e.g. notary submitting the shareholder lists).

II. Irritation Caused by the Regional Court in Frankfurt

In its ruling dated October 7, 2009, the Regional Court (*Landgericht – LG*) in Frankfurt took the concern expressed in the legal literature as an opportunity in an *obiter dictum* to deduce from a few modifications MoMiG had made to GmbHG that it was generally not permitted for GmbH share transfers to be notarized by a foreign notary public. In 2008 a new version of the Swiss law of obligations came into force to the effect that a share transfer needs only to be made in writing in order to be effective. However, the main argument of the Regional Court in Frankfurt was that the obligation in § 40 Subsection 2 GmbHG to submit a new shareholder list together with a certificate from the notary public to the commercial register after a share transfer could only be directed at German notaries public who are subject to the GmbHG and not at foreign notaries public and a foreign notary public could not therefore carry out the notarization of a share transfer.

Practical experience became irritated by the critical voices in legal literature and the decision by the Regional Court in Frankfurt so that share transfers were generally notarized by German notaries public.

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III. Clarification by the Higher Regional Court in Dusseldorf

The Higher Regional Court (*Oberlandesgericht – OLG*) in Dusseldorf decided in its ruling dated March 2, 2011, that neither MoMiG coming into force nor a modification in the Swiss law of obligations had an effect on the question whether notarization of a share transfer in Switzerland is effective.

The OLG in Dusseldorf correctly points out in its decision that the form of a legal transaction is valid pursuant to Art. 11 Introductory Act to the German Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch – EGBGB*) if it fulfills the form requirements of the law which applies to the legal relationship which is its subject matter (*legal form requirements – Geschäftsform*) or the law of the country where it is carried out (*local form requirements – Ortsform*). Even if the OLG in Dusseldorf does not explicitly state it, it seems to assume from the beginning that the legal form requirements, i.e. the requirement of notarization foreseen in German law, must be observed for a share transfer which was notarized in Switzerland to be valid. And it views this precondition to be fulfilled by a notarization in Switzerland. This also challenges the arguments of the LG in Frankfurt on the modification of the Swiss law of obligations since Swiss notary law and notarization law itself has not been modified so that the question of equivalence of notarization carried out in Switzerland should not be assessed differently than before the modification of the Swiss law of obligations.

Even the main argument of the *obiter dictum* by the LG in Frankfurt is contradicted in the decision by the OLG in Dusseldorf. Although it is correct that the notary public who is involved in modifying the shareholder status is obliged pursuant to § 40 Subsection 2 GmbHG to submit an updated list of shareholders instead of the managing director and that this obligation (under public law) can only relate to a German notary public, the regulation of who is responsible for submitting the list should be strictly separated from the actual notarization so that a foreign notary public could indeed carry out a valid notarization even if he/she is not obliged to submit the information in the sense of § 40 Subsection 2 GmbHG.

Nevertheless the OLG in Dusseldorf overshot the mark in its decision by allowing the foreign notary public to submit the new list of shareholders even if he/she is not obliged to do so. This approach which is certainly pragmatic fails to recognize that § 40 Subsection 2 GmbHG does not apply at all to a foreign notary public so that the managing directors remain obliged to submit an updated list of shareholders.

The legal status of the new list of shareholders which is submitted by the foreign notary public (who is not actually responsible for the submission) and included in the commercial register is not yet clarified. The liability risk is considerable here against the background of the proportional status of the shareholders who appear in the list for the first time (§ 16 Subsection 1 GmbHG) or the function of the list of shareholders for an acquisition in good faith (§ 16 Subsection 3 GmbHG).

IV. Conclusion

The OLG in Dusseldorf has now provided some clarity for the foreign notarization of share transfers again and reduced the number of critical voices in legal literature.

Nevertheless it must still be stated that the legal situation continues to remain uncertain since it is not yet regulated by law whether GmbH share transfers which have been notarized abroad are valid (the proposal to codify international corporate law is included in a ministerial draft dating from the beginning of 2008).

As well as the lack of absolute legal certainty it should also be considered that apart from the unique notary fees for foreign notarization in Switzerland there will also be further costs (consultancy fees for attending the notarization, flight costs to Switzerland, accommodation, etc.) which may not be inconsiderable so that the hitherto practiced notarization tourism may not be worth it for a not insignificant number of cases.

Rechtsanwalt Heiko Ramcke, Hanover

Comfort Letter – Federal Court of Justice provides further legal certainty

Comfort letters are widely used to prevent insolvencies of companies, in particular in times of crises. Although often used in practice, comfort letters are not subject to statutory codification. Therefore, the recent decisions by the Federal Court of Justice (*Bundesgerichtshof – BGH*) which clarified certain issues are highly welcome. After its widely noted decision regarding the possibility of terminating comfort letters during the crisis of a subsidiary (decision dated 20 September 2010, File No. II ZR 296/08 – reviewed in *Forum Juris 01/2011*), the BGH recently handed down a further decision with respect to comfort letters. The decision dated 19 May 2011 (File No. IX ZR 9/10) deals with the appropriateness of a comfort letter to prevent the insolvency of a subsidiary.

I. Facts

According to the underlying facts, the receiver sued a bank with which the debtor and its subsidiaries maintained current accounts organized as a cash pool. In this context, the debtor and its subsidiaries were granted a credit line. On 25 March 2002, when doubts arose regarding the liquidity of the debtor, the indirect shareholder of the debtor issued a binding comfort letter to the defendant. On 26 April 2002, the credit line was partially repaid by way of set-off with payments made to the account. On 29 April 2002, the defendant terminated the credit line, and, as a result, the debtor filed for the initiation of insolvency proceedings on 30 April 2002. The receiver then claimed reimbursement of the amount that was set-off on 26 April 2002.

II. Decision

Typically, comfort letters are declarations of the patron (usually the direct or indirect shareholder) stating that it will support the subsidiary financially. As summarized by the BGH in its recent decision, legal practice usually distinguishes between ”binding“ and ”non-binding“ as well as ”internal“ and ”external“ comfort letters. Whereas ”non-binding“ comfort letters are not legally binding but mere declarations of intent, ”binding“ comfort letters contain a legal obligation to support the subsidiary financially in a way that it will be able to meet its liabilities. Only the latter type of comfort letters can prevent insolvency in case of over-indebtedness.

In its recent decision, the BGH clarified that, besides the qualification as ”binding“ comfort letter, usually the classification as ”internal“ has to be fulfilled as well to prevent an insolvency. In case of an ”external“ comfort letter this only applies in exceptional cases. ”External“ comfort letters are not extended to the subsidiary, but given vis-à-vis a third party creditor and therefore, in contrast to ”internal“ comfort letters, do not constitute a claim of the subsidiary to be provided with sufficient liquidity. Furthermore, in case of insol-vency, an ”external“ comfort letter leads to the obligation to make direct payments to the third party creditor of the subsidiary. In its decision, the BGH ruled

that an ”external“ comfort letter can only prevent the subsidiary from becoming insolvent if the patron fulfils its obligation vis-à-vis the third party creditor by providing sufficient liquidity to its subsidiary. The mere grant-ing of an ”external“ comfort letter is not an appropriate means to prevent the subsidiary from becoming insolvent.

The BGH affirmed that the state of insol-vency continued despite the comfort letter and affirmed the possibility to challenge the set-off. The BGH was, however, unable to hand down a final decision, as not all of the facts had been ascertained. The case was therefore referred back to the Court of Appeal for further hearings.

III. Consequences for legal practice

With its latest decision, the BGH provides further clarification of open issues in this area which is extremely important for legal practice. Members of the management board who want to prevent illiquidity and, as a result, an insolvency of their company are advised to ensure that ”external“ comfort letters are drafted so as to grant the subsidiary a separate claim to be provided with sufficient liquidity, in addition to the claim of the third party debtor. In the future, one might hereto request ”internal“ comfort letters although this is less satisfactory for third party creditors as they cannot derive a separate claim vis-à-vis the parent company.

It remains to be seen what effect the decision will have on the behaviour of third party creditors and whether ”internal“ comfort letters will be widely accepted by them in the future. The additional legal certainty provided by the decision is welcome, although the result will most likely not only meet with praise in practice.

Rechtsanwältin Dr. Sabine Pittrof, LL.B. (Univ. N.S.W.) and Rechtsanwältin Julia Dolleschel, LL.M. (Univ. N.S.W.), Frankfurt am Main

Corporate Bonds – Financing Alternative for Medium-Sized Enterprises

In the past medium-sized enterprises have usually covered their capital requirements with classical equity instruments or debt capital, such as, e.g. shareholder loans or bank loans. Capital market-based financing forms, on the other hand, were only considered rarely. This was quite often due to the fact that the financing requirement of medium-sized enterprises did not generally reach the critical volume involving nine digits which was necessary for placing securities on the capital market. Financing away from the capital markets was also ”easier“ since it did not involve publishing the financial situation of the company.

As a result of the financial crisis and the associated reservation of the banks to grant loans, forms of financing which are independent of the banks have attracted more notice in the last two years. Various stock exchanges, including the one in Dusseldorf (*”mittelstandsmarkt“ – medium sized market*) and in Stuttgart (*”Bondm“ = bond market for medium-sized enterprises*), have set up special trading segments, for example, for issuing the bonds of medium-sized enterprises, enabling a placement with a starting volume of EURO 10 million (Dusseldorf) and/or EURO 25 million (Stuttgart). These lower entry thresholds to the capital market have awakened the interest of both institutional and private investors and thus created a generally favorable market environment for bonds. Corporate bonds which are listed on a stock exchange are thus increasingly becoming a real financing alternative for medium-sized enterprises. The corporate bond can be an important component in covering the financing requirements of medium-sized enterprises, particularly for enterprises with a high level of recognition and good creditworthiness – both being grounds for indispensable confidence in the capacity of the company to make the necessary payments.

I. Main Characteristics of Corporate Bonds

The corporate bond is an interest-bearing bond which is placed on the capital market and traded during its maturity period. The issuer promises repayment to the investor as well as interest on the invested amount at the conditions which are specified in advance. The investor’s resulting claim is securitized in a security paper.

Issuing a corporate bond leaves the shareholder structure unchanged. The corporate bond is thus a typical instrument to obtain capital from outside sources whose use is at the discretion of the management and does not usually need a resolution by the shareholder meeting or annual general meeting. It should be reviewed on a case-by-case level, however, whether the consent of the supervisory board or a voluntarily deployed advisory board is necessary.

As external investors, the bond holders cannot directly influence the corporate management. The rights of creditors are, however – just like the rights and duties of the bond debtor – specified in the terms and conditions of the bond which are also a fixed component of the bond certificate. The terms and conditions of the bond include information on the maturity of the bond and the amount of interest as well as the payment formalities. In many cases the terms and conditions of the bond also foresee a special right of termination for the bond holder if the issuer’s shareholder structure should change significantly during the maturity of the bond (so-called *Change of Control*).

In contrast to classical bank loans the terms and conditions of the bond rarely include stipulations on corporate management with regard to keeping to and/or maintaining certain financial covenants. Instead the issuer is obliged, however, to publish its financial situation and thus grant the capital market clearer transparency through financial reporting at regular intervals.

II. Preconditions for Inclusion – Prospectus and Rating

Including a bond in stock exchange trading and listing it in a particular trading segment for bonds of medium-sized enterprises is linked to a number of important preconditions. Although the latter vary depending on the stock exchange, the issuer must at least provide a prospectus which has been approved by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*) and have a corporate rating.

Drawing up a prospectus requires great care since it is the basis for providing information to the investors. The function of the prospectus is not advertising, however, since it is also the main basis of liability for possible compensation claims by the investors vis-à-vis the issuer who is liable pursuant to the principles of prospect liability if important information in the prospectus is incorrect or incomplete.

The prospectus includes all the information which is necessary to enable the public to make a true assessment of the issuer's prospects as well as the rights associated with the securities. This particularly includes information on the issuer's general business activities and information on assets and liabilities as well as profit and loss. The description of risk factors requires particular attention since they can have a direct effect on the issuer's ability to fulfill its obligations in the future as the bond debtor.

The results of a due diligence investigation which was carried out previously are often used to assemble the prospectus. The due diligence investigation examines the issuer's legal and economic relationships in detail and summarizes the resulting risks in a report.

Most of the rules and regulations of the individual bond segments for medium sized enterprises require a current corporate rating and therefore emphasize the quality-orientated and sustainable approach of the stock exchanges. Inclusion in the "mittelstandsmarkt" of the stock exchange in Dusseldorf requires a minimum rating of BB, for example. The rating agency which is commissioned by the issuer examines the profit and debt situation, the financial situation, the products as well as the customer and supplier relationships and on this basis awards a corresponding corporate rating.

III. Follow-Up Obligations

While listed on the stock exchange the issuer must observe a number of important follow-up obligations which vary slightly depending on the stock exchange location. The most important follow-up obligations of inclusion in the *"mittelstandsmarkt"* at the stock exchange in Dusseldorf include transparency of financial reporting, for example. The issuer must publish a certified annual statement of accounts six months after the end of the financial year at the latest and a half-year report three months after the end of the financial year at the latest. A follow-up rating and a corporate calendar with details of the most important dates for the issuer and bond must also be published once a year.

During the term of the bond the issuer must also observe the quasi-ad-hoc disclosure requirement included in the terms and conditions of the stock exchanges. This follows the example in § 15 German Securities Trading Act (*Wertpapierhandelsgesetz – WpHG*) and obliges the issuer to publish without undue delay specific, unpublished information which can influence the stock exchange price of the bond.

IV. Capital Market Partners

At the stock exchange in Dusseldorf the medium-sized issuers are assisted by selected capital market partners in preparing the Initial Bond Offering (IBO). At the issuer's request the capital market partners can manage the entire transaction process as well as take care of the legal aspects. *Raupach & Wollert-Elmendorff* is one of the founding partners of the *"mittelstandsmarkt"* in Dusseldorf.

Rechtsanwalt Dr. Dr. Boris Schilmar and
Rechtsanwalt Niko Jakovou, LL.M., Düsseldorf

Direct Transfer from the Board of Management to the Supervisory Board of Listed Stock Corporations

I. Introduction

With the Act on the Reasonableness of Management Board Remuneration (*Gesetz zur Angemessenheit der Vorstandsvergütung – VorstAG*) a regulation was included in the German Stock Corporation Act (*Aktiengesetz – AktG*) which prohibits direct transfer from the board of management to the supervisory board of companies listed on stock exchanges. Pursuant to § 100 Subsection 2, No. 4 AktG members of the board of management may not belong to the supervisory board of the company for a period of two years after leaving the board of management (so called "cooling off period"). Cipher 5.4.4 of the German Corporate Governance Code (*Deutscher Corporate Governance Kodex – DCGK*) was modified accordingly. The background behind this new regulation is to avoid any conflicts of interest when holding a position in the supervisory board and the concern that a former member of the board of management – particularly the chairman – could as a member of the supervisory board prevent a vital change of course or even discovery of his/her own mistakes. The new regulation is widely criticized in practice: the loss of important knowledge is also lamented apart from the unwelcome intervention of legislation in the company's autonomy regarding personnel matters.

There is an exemption where the two-year cooling off period is not required if the appointment of the former member of the board of management as a new member of the supervisory board takes place based on a proposal by one or more shareholders with more than 25% of the voting rights. The legislation considers that such a high share of the votes reflects the shareholders having sufficient control regarding the appointment of the supervisory board. Know-how and experience can also be retained by the company in this manner.

II. Initial Situation

In the past it was more often the rule than the exception that the chairman of the board of management transferred directly to the supervisory board and was generally the chairman there too. It can be observed more recently that the successful chairmen of the board of management, such as, e.g. Lufthansa, BASF and Bayer, do not transfer (any longer) to the supervisory board of the same companies after the end of their activities in the operative business. Use was hitherto seldom made of the statutorily foreseen exemption. However, recent press reports have stated that Deutsche Bank plans to go along this path for its current chairman of the board of management, Dr. Josef Ackermann.

Until the law was modified such a cooling off period was not foreseen in the DCGK recommendations which represent the principles of good corporate management. It was worded in Cipher 5.4.4 DCGK, however, that a transfer from the board of management to the chairman of the supervisory board or the chairman of one of the committees of the supervisory board should not be the rule. If there was corresponding intent, the reasons should be particularly stated in the shareholder meeting.

III. Exceptions to the Prohibition of Direct Transfer

The appointment of a member of the board of management to the supervisory board within this cooling off period is permitted as an exception if it takes place on a ”proposal“ by shareholders who hold more than 25 % of the voting rights. This should insure that principal shareholders do not have to relinquish ”the knowledge and skills of a deserving member of the board of management“. It is important in this context that the shareholder proposal for the appointment is made separately from the actual voting by the shareholder meeting. The following methods are feasible here in particular:

A formal proposal on the appointment of a former member of the board of management is made by one or more shareholders in the run-up to the shareholder meeting. The supervisory board then embraces the proposal and nominates the member of the board of management on the agenda for election with reference to the proposal by the major shareholder(s). The former member of the board of management is thus ”eligible for election“ and a separate preliminary vote in the shareholder meeting is no longer required. Several shareholders agreeing on a corresponding proposal does not in itself constitute acting in concert where the shareholders would otherwise incur special obligations based on the German Securities Trading Act (*Wertpapierhandelsgesetz – WpHG*). A precondition for such action would be a strategy to alter the corporate direction of the company significantly and on a permanent basis. However, it is precisely the appointment of a former member of the board of management which does not usually represent an alteration of the corporate direction of the company. Nor is the one-off agreement evidently long lasting joint action.

Furthermore the supervisory board can itself propose a former member of the board of management for election where there are no major shareholders in the company. However, the election in the shareholder meeting must then be preceded by a proposal procedure of the shareholders. The agenda can include ”supervisory board election“, for example, where a vote first takes place on the 25 % quorum. If this is achieved, the candidate can then be elected in the actual supervisory board election with a simple majority of votes. If the 25 % quorum is not achieved, another candidate must be elected. This ”substitute“ should already be nominated in the proposal by the supervisory board regarding the supervisory board election.

A third possibility is that the shareholder meeting submits a corresponding proposal from its midst. It must first be ascertained whether the quorum is achieved for this candidate to be eligible for election. The chairman of the shareholder meeting can bring this about by a corresponding vote before the actual supervisory board election as described above.

Further possibilities are a request by one or more shareholders to extend the agenda under the preconditions in § 122 Subsection 2 AktG or a counter proposal pursuant to § 127 in connection with § 126 AktG. If the 25 % quorum is lacking for the counter proposal submitted in the shareholder meeting and it appears completely impossible that it can be achieved, the chairman of the shareholder meeting will give the requesting party the possibility to win further shareholders over to his/her proposal.

IV. Conclusion

The introduction of the cooling off period has complicated the direct transfer of a member of the board of management to the supervisory board. However, transferring from the board of management to the supervisory board as in the case of the chairman of the board of management transferring to the supervisory board at Deutsche Bank, for example, is not at all illegal or only possible by ”cleverly exploiting a legal loophole“ as it was possible to read in some press reports. Instead the legislation has recognized that it continues to make sense in many cases to make use of the knowledge of a member of the board of management which has grown over many years in the supervisory board as well. It will generally be in the company’s interest if a successful chairman of the board of management now belongs to the supervisory board immediately after leaving the board of management. However, the shareholders must now achieve a minimum quorum in order to demonstrate this interest in the first two years after being active in the board of management.

Rechtsanwalt Dr. Peter Maser, Stuttgart

"Whistleblowing" as Reason for Dismissal – Decision by European Court of Human Rights Dated July 21, 2011

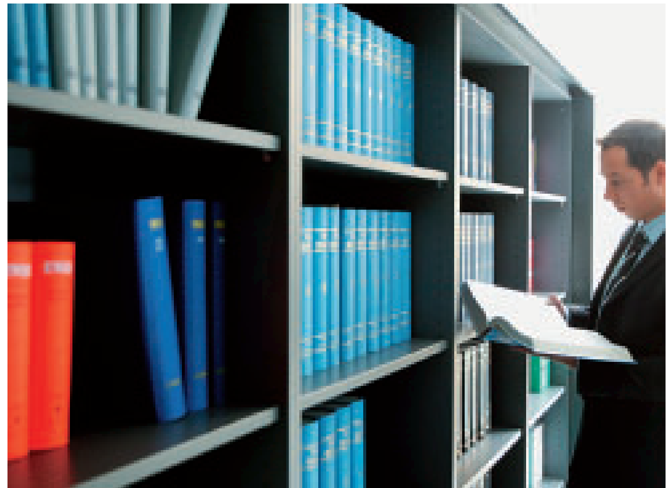
I. Facts of the Case

The claimant was employed as a geriatric nurse by vivantes GmbH in Berlin, a state enterprise in geriatric care. Between January 2003 and October 2004 the claimant notified her employer of flaws at her workplace. The nursing staff were overworked, there were faults in the standard of care and the nursing care was not documented accurately. The claimant's details were confirmed by the Medical Review Board *(Medizinischer Dienst)* in November 2003. The employer dismissed the allegations.

In December 2004 the claimant filed a criminal complaint based on severely aggravated fraud pursuant to § 263 Subsection 3 German Penal Code *(Strafgesetzbuch – StGB)*. Already in January 2005 the public prosecutor in Berlin discontinued the investigations commenced against the employer.

On January 19, 2005, the employer served an ordinary termination of the employment relationship with the claimant based on various absences due to illness (90 days in 2004) to become effective on March 31, 2005.

With support from the ver.di trade union the claimant distributed a leaflet on January 27, 2005 that inter alia indicated the criminal complaint based on aggravated fraud which she had filed. The employer learned about the criminal complaint from the leaflet for the first time and thereupon again made an extraordinary termination of the employment relationship with the claimant on February 9, 2005, without notice or alternatively an ordinary termination with due notice.



The complaint against unfair dismissal which was filed with the Labor Court in Berlin was successful. In March 2006, however, the Higher Labor Court *(Landesarbeitsgericht)* annulled the Labor Court ruling. The criminal complaint which the claimant had filed constituted good cause providing the grounds for a termination of the employment relationship without notice. Nor was it protected by the right to freedom of expression. The Federal Labor Court *(Bundesarbeitsgericht)* dismissed the appeal against denial of leave to appeal. The Federal Constitutional Court *(Bundesverfassungsgericht)* did not accept the case to make a decision on the constitutional complaint which was filed against this aspect. The claimant then invoked the European Court of Human Rights (ECtHR) and asserted an infringement of Article 10 (freedom of expression) of the European Convention on Human Rights (ECHR).

Raupach
& Wollert-Elmendorff
Rechtsanwaltsgesellschaft mbH

II. Decision

The ECtHR decided that the termination of the employment relationship and the decisions by the German courts constituted an infringement of Article 10 ECHR. The Federal Republic of Germany was obliged to pay to the claimant EURO 10,000.00 for the immaterial damage she incurred and a further EURO 5,000.00 for the costs she incurred.

The ECtHR believes that the criminal complaint filed by the claimant constitutes a case of "whistleblowing", i.e. an employee revealing grievances in an enterprise or institution, where Article 10 ECHR is applicable. The articulated termination without notice and the associated decisions of the German courts are an intervention in the freedom of expression permitted by Article 10 ECHR.

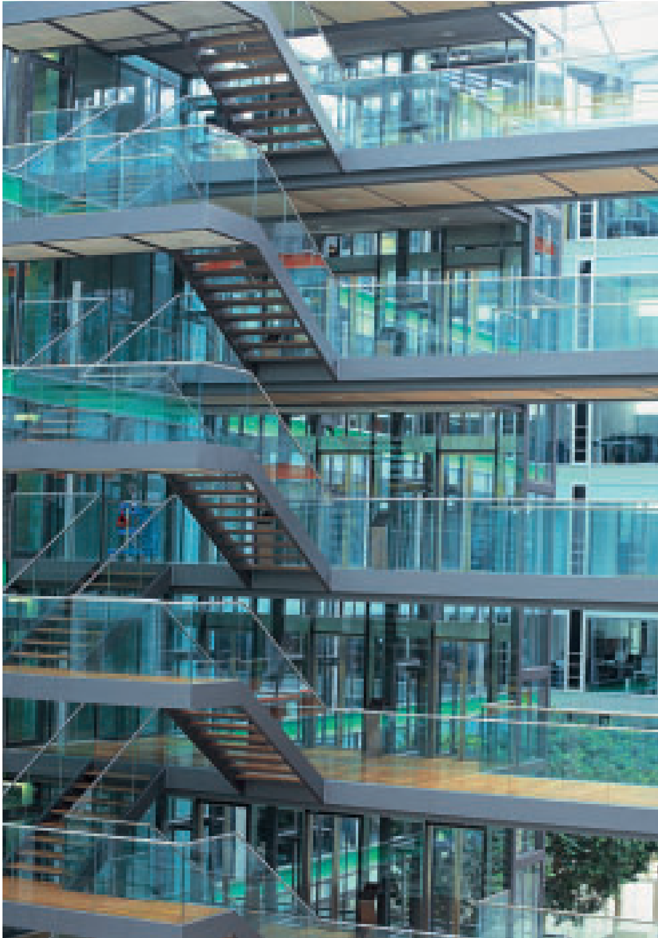
This intervention is, however, "foreseen by law" in the sense of Article 10 Subsection 2 ECHR since the German stipulation in § 626 German Civil Code *(Bürgerliches Gesetzbuch – BGB)* allows a service agreement to be terminated without a notice period if there is "good cause" that the party articulating the termination cannot be expected to continue the employment relationship. A criminal complaint filed against an employer can constitute "good cause" in the sense of § 626 BGB if there is considerable infringement of the duty of loyalty. The termination then pursued the legitimate intention of protecting the employer's reputation and interests.

It is necessary to weigh up the employer's interests, the claimant's right to freedom of expression and the public interest in the information about the alleged grievances at the workplace in order to answer the question whether a termination based on "whistleblowing" infringes Article 10 ECHR.

The ECtHR ascertains here that there is public interest regarding the information on the apparent faults, especially since the patients concerned are not in a position themselves to draw attention to the grievances. The claimant had already revealed the underlying grievances and inaccuracy of the documentation to her employer in vain before filing the criminal complaint. Further in-house complaints with respect to the employer's conduct were futile. The ECtHR is of the opinion that it was then not detrimental that the employer's conduct was stated as severely aggravated fraud in the legal assessment of the criminal complaint for the first time.

The claimant did not knowingly or lightheartedly give any incorrect statements. The concern she expressed was confirmed in the Medical Review Board's criticism. Although the public prosecutor discontinued the investigations into the employer's conduct with regard to the criminal complaint, it could not be demanded of the person who filed the criminal complaint to foresee whether the investigations would lead to an official charge or would be discontinued. The ECtHR furthermore ascertained that the claimant had acted in good faith. It would not have been clear to her in view of the regular checks by the Medical Review Board that the criminal complaint was unnecessary or superfluous since the complaints by the Medical Review Board had not led to an improvement in the care situation at the employer either.

The ECtHR ascertained that the allegations made by the claimant had a damaging effect on the employer's reputation and business interests. Yet the ECtHR believed that the public interest in information about faults in institutional geriatric care in a state organization is so important in a democratic society that it overrides the company's interest to protect its reputation and business interests.



The articulated extraordinary termination without notice is the harshest sanction which is conceivable under labor law. It not only has negative consequences for the claimant's professional career but also acts as a deterrent for the employer's other employees. The sanction could even be a deterrent for other employees in the care sector through reports in the media. The ECtHR believed that the German courts did not therefore strike an appropriate balance between the necessity to protect the employer's reputation and the claimant's right to freedom of expression.

There was therefore an infringement of Article 10 ECHR. The ECtHR believed that filing the criminal complaint was therefore protected by Article 10 ECHR.

III. Practical Consequences

The decision by the ECtHR does not lead to the fact that employees can now safely file criminal complaints against their employers. The federal state of Berlin holds an interest in the employer enterprise. The existing public interest in the information which the decision bears will probably only need to be taken into account within a balance of interests in special cases such as the instant one of institutional geriatric care where an employer is owned by the state. If such public interest does not exist, the previous court decisions by the Federal Labor Court *(Bundesarbeitsgericht – BAG)* on filing criminal complaints against an employer are applicable (cf. BAG Ruling dated July 3, 2003 – Case Nos. 2 AZR 235/02, NZA 2004, 427).

Employers should always take employee allegations seriously and seek internal clarification. Termination based on "whistleblowing" is risky.

Employees can only be warned from turning directly to authorities or the public without following internal clarification procedures.

Pursuant sec. § 580 No. 8 Code of Civil Procedure *(Zivilprozessordnung – ZPO)* the claimant could demand the resumption of the legal action against unfair dismissal in the instant case with the result that the employer may under certain circumstances have to bear considerable financial burdens based on default of acceptance of existing claims for remuneration.

Rechtsanwalt and Certified Specialist Lawyer in Labor Law Markus Wolferseder, Stuttgart

Internal Raupach News

The Corporate Service Line at Raupach

We wish to continue the presentation of the national Service Lines which exist at Raupach by presenting our Corporate Service Line to you in this edition:

Variety of Advice

We offer our clients the entire range of corporate legal advice with our Corporate Service Line. This covers both the establishment and management of corporations *(Kapitalgesellschaft)* and partnerships *(Personenhandelsgesellschaft)* under corporate law and legal advice with respect to special topics such as corporate governance (rights and duties of the board of management/managing directors, supervisory board), concluding/terminating corporate agreements (domination and profit and loss transfer agreements, management agreements, etc.), capital maintenance/cash pooling, etc.

Our clients benefit here from our extensive wealth of experience in rendering legal advice and accompanying long-term assignments as well as complex projects, in particular for national and international corporate groups.

Our wish is to integrate our clients' entrepreneurial specifications and issues into the relevant structures under corporate law in the best possible manner.

Yet another facet point of consulting is providing restructuring advice as well as accompanying complex restructuring measures and – cross border – transformation procedures while setting up a European Public Limited Liability Company *(Societas Europaea or SE)*, for example.

Advice on long-term corporate succession issues along with inheritance law and inheritance tax arrangements as well as the inclusion of family law aspects should also be mentioned. This can cover both the classical corporate succession with children and introducing a special trust arrangement or utilizing the M&A expertise in our M&A Service Line to render advice during a corporate sale or accompanying a client in the search for a strategic partner/investor.

Fifty Attorneys at Seven Locations

With a total of fifty attorneys at seven locations the *Corporate* Service Line is the largest Service Line at Raupach and is well equipped with staff for handling extensive projects. The Corporate Service Line is headed up by Dr. Harald Stang and Sandra Laves, both in Hanover. The fifty attorneys include professionals of all ranks so that effective teams can be formed even across different locations and at any time to match our clients' needs and the individual requirements of a specific project.

Cooperation with Deloitte

The *Corporate* Service Line cooperates very closely with the various functional groups and Service Lines at Deloitte thus offering our clients a special multidisciplinary approach in corporate legal advice. It can frequently be seen particularly in the field of corporate law that the complex arrangements in a modern economic world also show fiscal or accounting aspects as well as legal issues and affect various other areas. Our clients benefit here from the understanding our staff has for such interaction.

Inclusion in an International Network

Raupach is part of an international network of more than 3,200 attorneys in over 40 countries. The national Service Lines each have an international equivalent. The *Corporate* Service Line is therefore part of the international *Corporate* Service Line. This close relationship enables the client to get hold of a legal contact in all the main jurisdictions of the world as soon as possible. The members of the Service Line regularly liaise with attorneys in the respective countries for large multinational projects in order to be able to present the client with a consistent and high-quality result. Furthermore the inclusion in the international network offers us the possibility to make comparative legal analyses within a very short time period and such analyses can serve clients as a basis for their decisions.

Practice-Oriented Events

Apart from rendering legal advice on current issues we also regularly inform our clients and interested participants – often together with our business partner Deloitte – about developments in recent high-court decisions and legislation as well as current legal subjects of interest in the course of our in-house conference events.

Further Information

We would be pleased to be able to provide you with more details on the Corporate Service Line and its members either as a brochure or in electronic form.

Please do not hesitate to contact us!

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Raupach Partner Appointed Professor

Dr. Dr. Christoph Stumpf, Partner in our Hamburg office, was appointed an adjunct professor by the President of the University in Halle Wittenberg based on his merit in research and teaching.

Prof. Dr. Dr. Stumpf earned his law doctorate at the University in Munich and a doctorate in theology at the University of Oxford and qualified as a professor in public law at the University in Halle Wittenberg. He has been a Partner at Raupach since 2007 where he advises clients in public business law and procurement law, intellectual property rights and foundation law. His clients include medium-sized and large enterprises both in Germany and abroad and institutions under public law. For example, in 2011 Prof. Dr. Dr. Stumpf thus managed the legal advice regarding the establishment of KIC InnoEnergy SE as the first European Public Private Partnership in the legal form of a European public limited liability company and which enjoys a reputation as a Knowledge and Innovation Centre of the European Institute for Innovation and Technology (EIT). Prof. Dr. Dr. Stumpf is the author of numerous specialist publications, such as the legal commentary on foundation law by *Stumpf/Suerbaum/Schulte/Pauli*, shortly to be published by C. H. Beck.

Upcoming Events

We are pleased to be able to hold the

Japanese Client Seminar
Recent legal, tax and
accounting developments

with Deloitte this year again.

The event which is particularly tailored to our Japanese clients will take place on the following dates:

Dusseldorf – Tuesday, October 18, 2011
Frankfurt – Tuesday, October 25, 2011
Munich – Thursday, November 10, 2011 and
Hamburg – Tuesday, November 15, 2011

from 14:00 hours through 18:00 hours in the respective Raupach/Deloitte offices.

The event which will take place for the sixth consecutive year will present current legal and fiscal topics as well as issues under German accounting law. It will be held in English with Japanese translation and summaries.

You can obtain further information from our Japan Desk:

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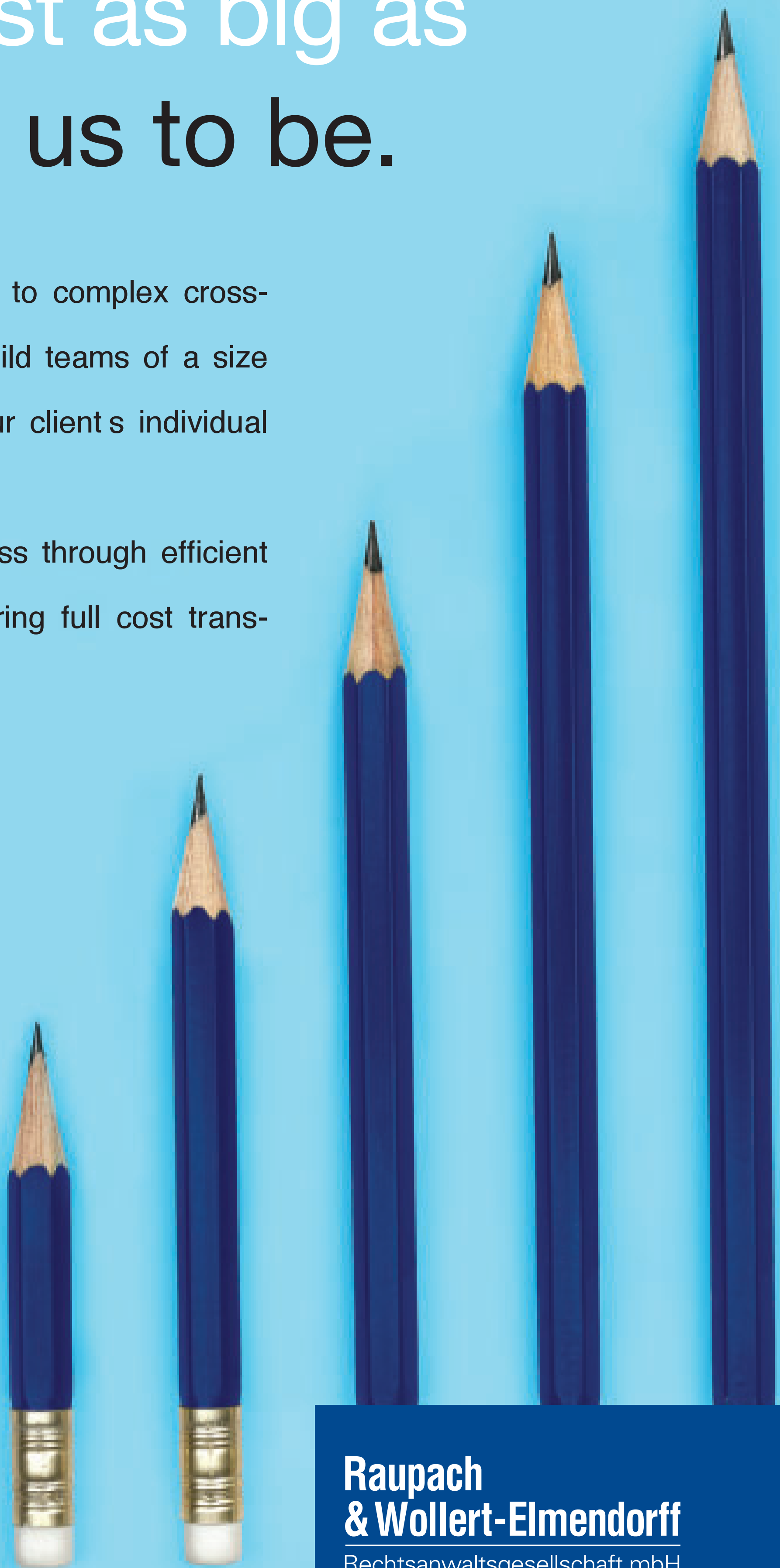

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