Regulation of Affiliated Parties - Germany

1. Executive Summary.

There is no universal definition of an “affiliated party” in German legislation that is consistently used in all areas of law. The Stock Corporation Act (Aktiengesetz) provides a detailed set of definitions encompassing various situations in which a person or entity will be characterized as an affiliated party. This concept of an affiliated party as defined by the Stock Corporation Act is also used in a number of other areas of law. However, there are also areas of law which have developed their own definition of an “affiliated party” (or similar terms) based on criteria that are different from those utilized by the Stock Corporation Act.

No stand-alone laws have been enacted in Germany to address specifically the concept of affiliated parties and the issues related thereto. However, such issues are addressed in a number of statutes, including in particular the aforementioned Stock Corporation Act.

German law provides for specific disclosure, reporting and accounting requirements in respect of affiliated parties. Certain information regarding affiliated parties is to be filed with public authorities or government agencies, including in particular the Registry of Commerce (Handelsregister) and the Federal Financial Services Supervisory Agency (Bundesanstalt für Finanzdienstleistungsaufsicht, BAFin). Each of these agencies disposes of its own set of powers and penalties to enforce compliance with the reporting and filing requirements.

2. Question-by-Question Answers.

Question 1.

A. Question:

How does the legislation of Germany define the concept of an “affiliated party”?

B. Response:

1. Corporate and Company Law.

Section 15 of the German Stock Corporation Act (Aktiengesetz) defines the circumstances under which a company will be considered to be an affiliated party of another company. Section 15 reads as follows:

“Affiliates are legally independent enterprises, which in relationship to one another are majority-held and majority-holding enterprises (Section 16), controlled or controlling enterprises (Section 17), group companies (Section 18), companies with cross-shareholdings (Section 19), or parties to an enterprise agreement (Sections 291 and 292).”
Under this definition, companies are considered affiliated parties in the following five situations:

- majority shareholdings (\textit{Mehrheitsbeteiligung}, Section 16): a company holds (directly or indirectly) the majority of shares or voting rights in another company;

- control (\textit{herrschende Unternehmen}, Section 17): a company is able to control another company directly or indirectly. In the case of majority shareholdings the law presumes the existence of control. Control may also result from other circumstances unrelated to the number of shares owned, such as, for instance, a \textit{de facto} majority of the voting rights due to the regular absence of an important number of shareholders in the shareholders’ assembly, or a strong representation on the company’s supervisory board;

- existence of a group of companies (\textit{Konzern}, Section 18): if a controlling company and one or more controlled companies are subject to the same management as the controlling company, then such companies constitute a group of companies, and all companies belonging to such group of companies are considered to be affiliated parties. In case of control of one company by another company the law presumes the existence of a group of companies;

- cross-shareholdings (\textit{wechselseitig beteiligte Unternehmen}, Section 19): two companies hold more than 25\% shareholding in each other;

- existence of an enterprise agreement (\textit{Unternehmensvertrag}, Sections 291, 292): pursuant to German law it is possible for a company to enter into an agreement under which such company agrees to surrender the management of its business affairs to another company (control agreement, \textit{Beherrschungsvertrag}) or transfer its entire profits to another company (profit transfer agreements, \textit{Gewinnabführungsvertrag}).\textsuperscript{1} The parties to such an agreement are affiliated parties by operation of law.

2. Utilization of Concept of “Affiliated Party” (as defined in the Stock Corporation Act) in Other Areas of Law.

The concept of “affiliated party” as defined by the Stock Corporation Act is utilized in a number of other areas of law:

Pursuant to Section 8 of the German Reorganization Act (\textit{Umwandlungsgesetz}), the merger report to be prepared by the management of a company contemplating a merger with another company must include material information regarding the affiliated parties of the companies that are planning to merge. For the purposes of elucidating the concept of an affiliated party, the definition of the Stock Corporation Act has been incorporated by reference into the Reorganization Act.

\textsuperscript{1} Control agreements and profit and loss transfer agreements are the most common types of enterprise agreements. However, there are other types of enterprise agreements, such as profit pooling agreements and agreements to lease the entire business operations of a company to another company.
The concept of affiliated party developed by the Stock Corporation Act is also used in the German Act Against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*). Under this legislation, a party to a merger and its affiliated parties generally will be considered to be a single business enterprise for merger control purposes.  

3. **Rules Governing the Preparation of Consolidated Financial Statements.**

The concept of an affiliated party is also relevant in the context of the preparation of financial statements, when determining whether a company is required to prepare consolidated accounts and if the accounts of a given subsidiary or affiliate need to be included in such consolidated accounts. In that respect, the rules governing the preparation of consolidated financial statements and accounting principles set forth by the German Commercial Code (*Handelsgesetzbuch*) use certain (but not all) aspects of the affiliate concept as defined by the Stock Corporation Act. In addition, the rules governing the preparation of financial statements have defined their own complementary criteria which are not identical to those used to define an affiliated party in the Stock Corporation Act.

For instance, one of the consolidation tests provided for by the rules governing the preparation of financial statements uses the concept of a “participation in another enterprise that is intended to serve the company’s business through the creation of a durable connection.” An alternative consolidation test also turns on the existence of a control relationship, which can be established by (i) a majority of the voting rights, (ii) a right to nominate the majority of the members of the management or supervisory body of the company or (iii) a right to exercise a controlling influence on the company based on a control agreement or a specific provision of the by-laws of the company.

4. **Securities Law.**

In the context of public tender offers, the Acquisition of Securities and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*) provides for its own separate “control” definition that is unrelated to the control concept used by the Stock Corporation Act for defining the concept of affiliated party. Under the Acquisition of Securities and Takeover Act, “control” is defined as the holding of at least 30% of the voting rights of the target company. It further stipulates that for the purposes of the aforementioned test, voting rights held by a “subsidiary” (*Tochterunternehmen*) of the bidding company are deemed to be voting rights of the bidding company. While the concept of a “subsidiary” seems similar to that of an affiliated party as used by the Stock Corporation Act, it differs somewhat by virtue of its reference to the rules governing the preparation of financial statements. Specifically,

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2 Section 36 para. 2 of the Act Against Restraints of Competition. This provision refers to the existence of a control relationship and a group of companies, as defined by the Stock Corporation Act.

3 Sections 290 para. 1, 271 para. 1 of the Commercial Code.

4 Section 290 para. 2 of the Commercial Code.

5 Section 29 para. 2 of the Acquisition of Securities and Takeover Act.

6 Section 30 para. 1 no. 1 of the Acquisition of Securities and Takeover Act.
such term is defined as a company (i) in respect of which another entity can exercise a controlling influence or (ii) which is deemed to be a subsidiary the accounts of which are required to be included in consolidated financial statements pursuant to the rules governing the preparation of consolidated financial statements.\textsuperscript{7}

The concept of an affiliated party is also relevant to the provisions of the Securities Trade Act (Wertpapierhandelsgesetz), in particular in the context of insider trading. The group of persons suitable to qualify as an insider is defined statutorily as including, \textit{inter alia}, the members of the management or supervisory body or the general partners of (x) the company issuing the relevant securities or (y) an enterprise affiliated with such company.\textsuperscript{8} It appears that the latter reference to the term of affiliated enterprise means the concept of affiliated party as defined by the Stock Corporation Act.

However, the Securities Trade Act also uses the concept of a “subsidiary”, which is defined therein not by reference to the term of affiliated party but in the same way as under the Acquisition of Securities and Takeover Act (\textit{i.e.}, by reference to the rules on the preparation of financial statements, or based on the exercise of a controlling influence).\textsuperscript{9} Under the Securities Trade Act the concept of a “subsidiary” is relevant in connection with the reporting duties with which a shareholder must comply if certain voting rights thresholds are exceeded. For the purposes of these reporting duties, the voting rights held by a “subsidiary” of a shareholder are deemed to be voting rights of such shareholder.

5. \textit{Banking Law.}

The Banking Act (Kreditwesengesetz), which sets forth the regulatory framework for the exercise of banking activities in Germany, uses its own concepts to define affiliated or related parties. Under the Banking Act, these terms are particularly relevant in determining the scope of the various reporting obligations and other regulatory duties and restrictions that are set forth in such Act.

The concepts used by the Banking Act include in particular the term of “significant participation” and “close connection”. A “significant participation” is defined as (i) the holding of at least 10\% of the shares or voting rights of another company or (ii) the possibility to exercise a controlling influence on the management of another company.\textsuperscript{10} For the purposes of determining the voting rights, the Banking Act refers to the aforementioned provision of the Securities Trade Act pursuant to which voting rights held by a “subsidiary” of a shareholder are deemed to be voting rights of such shareholder.

The Banking Act concept of a “close connection” is defined therein as (i) the holding of at least 20\% of the shares or voting rights of another company or (ii) a parent-subsidiary connection of a similar nature or (z) a connection as “sister companies”.\textsuperscript{11}

6. \textit{Other Laws.}

\textsuperscript{7} Section 2 para. 6 of the Acquisition of Securities and Takeover Act.
\textsuperscript{8} Section 13 para. 1 no. 1 of the Securities Trade Act.
\textsuperscript{9} See, for instance, Section 22 para. 3 of the Securities Trade Act.
\textsuperscript{10} Section 1 para. 9 of the Banking Act.
\textsuperscript{11} Section 1 para. 10 of the Banking Act.
In addition to the laws discussed above, there is a variety of other laws which use concepts that are similar to the aforementioned definitions of affiliated or related parties. Generally, such laws are not specifically related to the context of corporate law and corporate governance and we have therefore refrained from discussing such laws in this memorandum.

**Question 2.**

A. Question:

What characteristics must an entity have in order to be recognised as affiliated?

B. Response:

Please see response to Question 1.

**Question 3.**

A. Question:

To what entities do the rules concerning regulation of the activities of affiliated parties apply?

B. Response:

The concept of an affiliated party as established by the Stock Corporation Act in respect of stock corporations and used by a number of other laws generally applies to all forms of business, whether directly or mutatis mutandis. Specifically, this concept has been extended to apply to limited liability companies and, to some extent and under certain circumstances, partnerships. Under certain limited circumstances, even a private individual can be characterized as an enterprise and thus be an affiliated party of another person or business entity. This is the case if an individual is a controlling shareholder of a company and at the same time also pursues significant business interests outside of such company.

The definitions of affiliated or related parties that have been developed by a number of laws separately from the concept used by the Stock Corporation Act generally apply to the entities which are being regulated by the relevant law or which carry out the activities that are addressed by such law. For instance, under the Banking Act, the concepts of “significant participation” and “close connection” primarily apply to banking establishments and financial institutions. However, such rules are normally not limited to certain forms of business or types of legal entities.

The rules governing the preparation of consolidated financial statements set forth by the German Commercial Code (Handelsgesetzbuch) and the affiliate or subsidiary concept related thereto apply only to corporations (Kapitalgesellschaften), i.e., stock corporations, limited liability companies and limited partnerships the only general partner of which is a limited liability entity.

**Question 4.**
A. Question:

On what grounds and subject to what conditions may the parties be classified as affiliated parties in Germany?

B. Response:

Please see response to Question 1.

Question 5.

A. Question:

What is the procedure for recognising or deeming a party to be “affiliated” in Germany?

B. Response:

In general, a party will become “affiliated” by operation of law. The determination of whether a party is “affiliated” does not require a particular decision by or registration with a public authority.

An exception to the aforementioned principle applies where a company is to be characterized as an affiliate based on the execution of an enterprise agreement (see response to Question 1, point 1 above). Such agreements and hence the affiliation resulting therefrom become effective only upon registration of the agreement in the Registry of Commerce.\(^\text{12}\)

Question 6.

A. Question:

Have any separate laws specifically concerning affiliated parties been adopted in Germany?

B. Response:

No.

Question 7.  [eliminated pursuant to September 17, 2004 meeting]

Question 8.

A. Question:

What is the procedure in Germany under which a legal entity or its participants files, maintains, and discloses information on its affiliated parties of a legal entity?

\(^{12}\) Section 294 para. 2 of the Stock Corporation Act; Section 54 para. 3 of the Limited Liability Company Act which applies *mutatis mutandis* pursuant to a decision of the German Federal Court of Justice (*Bundesgerichtshof*), published in NJW 1992, 1452.
B. Response:

1. **Reporting on Relations with Affiliated Parties.**

The management board of a controlled stock corporation must prepare a special report describing in a fair and accurate manner the company’s relations and dealings with affiliated companies (as such term is defined in the Stock Corporation Act).\(^{13}\) The report must include a statement as to whether the transactions entered into with affiliated parties were fair and at arm’s length, or, if that is not the case, whether the company has been compensated for any disadvantages suffered as a result of such transactions. This report is to be submitted to the supervisory board and the company’s statutory auditors for their review in the context of the audit of the company’s annual financial statements. No such report must be provided if the company has entered into a control agreement or a profit transfer agreement with the relevant affiliated parties.

2. **Significant Shareholdings.**

A shareholder acquiring (i) more than 25% of a stock corporation’s shares or (ii) a majority shareholding in a stock corporation must immediately give notice thereof to the stock corporation.\(^{14}\) Shares held by an affiliated party of the relevant shareholder are deemed to be shares of the latter. A similar notice must be given if the aforementioned thresholds are no longer met. The stock corporation must publish such notice in the Federal Gazette (**Bundesanzeiger**). As long as the relevant notice to the stock corporation has not been given, the shareholder is not entitled to exercise his voting rights and the payment of dividends to such shareholder is suspended.

In the case of a company whose shares are listed on a stock exchange additional notifications to the Federal Financial Services Supervisory Agency are required if certain thresholds are met, exceeded or no longer met.\(^ {15}\)

The Acquisition of Securities and Takeover Act imposes further reporting and disclosure requirements in connection with compulsory tender offers. Any person or entity acquiring control of a stock corporation must disclose the details thereof, including the share of the voting rights.\(^ {16}\) Thereafter, the shareholder must then submit a compulsory tender offer

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\(^{13}\) Section 312 of the Stock Corporation Act. In addition, any shareholder of a stock corporation generally has the right to request from the management board during the annual shareholders’ assembly to provide information regarding the legal and business relations between the company and its affiliated companies, see Section 131 para. 1, 2nd sentence of the Stock Corporation Act. Under certain circumstances, a shareholder may further request that a special auditor be appointed in order to audit such business relations, see Section 315 of the Stock Corporation Act.

\(^{14}\) Section 20 of the Stock Corporation Act. The content of the notice is limited to identifying the relevant shareholder and indicating that the relevant threshold has been exceeded. The stock corporation itself is subject to similar notification requirements if it acquires more than 25% or a majority shareholding in another corporation, see Section 21 of the Stock Corporation Act.

\(^{15}\) Section 21 of the Securities Trade Act. The thresholds are 5, 10, 25, 50 and 75% of the voting rights.

\(^{16}\) Section 35 of the Acquisition of Securities and Takeover Act. The information must be published in a national newspaper and by means of an electronic information system which is broadly used among credit institutions and financial service providers. As noted in the response to Question 1 (Point 4) above, for the purposes of this provision, control is defined as the holding of at least 30% of the voting rights.
for all shares of the relevant corporation (other than shares held by the corporation itself or for its account or by an affiliate of the corporation).

**Question 9.**

A. **Question:**

Does the legal entity have any obligations to record or account for its affiliated parties?

B. **Response:**

The parent company of a group of companies fulfilling one of the consolidation tests described in the response to Question 1 (point 3) above is required to prepare consolidated accounts (Konzernabschluß) for the entire group.\(^{17}\) The consolidated accounts must include a report (Konzernlagebericht) to be prepared by the parent’s management describing the state of the group’s business.\(^{18}\) The consolidated accounts must be filed with the Registry of Commerce.\(^{19}\) Please note, however, that “small groups” are exempt from certain consolidating requirements.\(^{20}\)

**Question 10.** [eliminated pursuant to discussions on September 17]

**Question 11.**

A. **Question:**

What are the powers and authority of the competent government agency, in Germany, which collects information on affiliated entities in Germany, in cases where such information is presented to the agency?

B. **Response:**

As indicated above, certain information regarding affiliated companies must be notified to or filed with the Registry of Commerce. If such information is not duly provided, the Registry of Commerce may impose coercive penalties (Zwangs- und Ordnungsgelder) of up to EUR 25,000 against the members of the management of the relevant company to enforce compliance with such obligations.\(^{21}\) In addition, the Registry of Commerce may impose a fine (Bußgeld) of up to EUR 25,000.\(^{22}\)

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\(^{17}\) Sections 290 et seq. of the Commercial Code.

\(^{18}\) Section 315 of the Commercial Code.

\(^{19}\) Section 325 para. 3 of the Commercial Code.

\(^{20}\) As defined in Section 293 of the Commercial Code.

\(^{21}\) Sections 335 and 335a of the Commercial Code.

\(^{22}\) Section 334 of the Commercial Code.
The Federal Financial Services Supervisory Agency has ample investigation rights under the Banking Act, the Securities Trade Act and the Takeover Act. In case of non-compliance with notification obligations, it may impose fines (Bußgeld) which may amount to up to EUR 1,000,000.

**Question 12.**

A. Question:

Who may obtain information on affiliated entities from the respective state authority or organization in Germany?

B. Response:

Information to be filed with the Registry of Commerce is public record and may be consulted by anyone. The information contained in the notifications to be made to the Federal Financial Services Supervisory Agency regarding applicable shareholding thresholds is published in publicly available media, such as the Federal Gazette or national newspapers, and is therefore publicly available.

**Question 13.**

A. Question:

Does Germany impose any liability (in particular, administrative) for violation of the requirements to provide information on affiliated parties?

B. Response:

Please see response to Question 11.

In addition, failure to comply with informational requirements regarding affiliated parties may trigger sanctions under civil and criminal law. As noted in the response to Question 8 (point 2) above, a shareholder failing to disclose a significant shareholding is not entitled to exercise its voting rights and the payment of dividends to such shareholder is suspended. Inaccurate representations made in the consolidated accounts of a group of companies may expose management to criminal liability.

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23 Section 40 of the Takeover Act, Section 29 of the Securities Trade Act, Section 44b of the Banking Act.

24 Sections 10 para. 1 and 60 of the Acquisition of Securities and Takeover Act; the fines may amount to up to EUR 50,000 in case a notification relating to certain thresholds of shareholding in publicly traded companies is omitted (Sections 21 para. 1 and 39 of the Securities Trade Act).

25 Section 9 of the Commercial Code.

26 See Section 331 of the Commercial Code.
Question 14.

A. Question:
What limitations does Germany impose on the rights of affiliated parties? In particular, what requirements are there for transactions with affiliated parties?

B. Response:

1. Transactions with Controlled Affiliates
With respect to limited liability companies and partnerships, courts have developed the general principle that a controlling entity may not exercise its control in a manner detrimental to its affiliates. All transactions between a controlling entity and its affiliates must therefore be at arm’s length, and any instructions given by the controlling entity must serve the interests of the affiliate. A controlling entity not complying with this principle will be obliged to compensate its affiliate for the losses suffered by the latter as a result of the relevant detrimental transaction or instruction.

This principle has been restated in the Stock Corporation Act and it therefore generally also applies to stock corporations. However, different rules apply if a control agreement has been entered into between a stock corporation and its affiliate(s). If a control agreement is in place, the Stock Corporation Act expressly authorizes the controlling entity to give detrimental instructions to the controlled affiliate (provided such instructions serve the interest of the controlling entity or the overall group of companies). In other words, the restrictions discussed in the preceding paragraph do not apply, and the controlling entity may enter into agreements with its affiliates that are not at arm’s length. This approach can be explained by the fact that companies which have entered into a control agreement (or any other type of enterprise agreement) are subject to very detailed and specific rules protecting the controlled affiliate, its minority shareholders and creditors at various levels. Under certain conditions, these rules also apply to limited liability companies that have entered into a control agreement.

2. Restrictions Applying to Self-dealing Situations
A shareholder of a limited liability company may not participate in the vote on a shareholders’ resolution which pertains to a transaction between the company and himself. The Stock Corporation Act subjects stock corporations to a similar but more narrowly drafted restriction.

27 Section 311 of the Stock Corporation Act, which reflects the principle that the controlling entity must (x) either refrain from exercising its control in a manner that is detrimental to the affiliate or (y) compensate the affiliate for any losses suffered as a result of instructions that are detrimental to the affiliate.
28 Section 308 of the Stock Corporation Act.
29 For instance, the controlling entity must compensate the yearly losses of the controlled entity and pay fair compensation to the minority shareholders of the controlled entity. Sections 302 and 304 of the Stock Corporation Act.
30 Section 47 para. 4, 2d sentence of the Limited Liability Company Act.
31 Section 136 of the Stock Corporation Act.
Additional restrictions apply to dealings between a stock corporation and its management. By operation of law, the authority to represent the stock corporation for the purposes of such transactions is vested in the Supervisory Board.
3. **Relevant Extracts of Legislation.**

Please see attached Annex A.

Legislation

- Aktiengesetz – Stock Corporation Act, dated September 6, 1965, Federal Law Gazette (Bundesgesetzblatt, BGBl.). I S. 1089, as amended
- Gesetz betreffend die Gesellschaft mit beschränkter Haftung – Limited Liability Company Act, re-enacted May 20, 1898, RGBl. S. 846, as amended
- Gesetz gegen Wettbewerbsbeschränkungen – Act Against Restraints of Competition, dated August 26, 1998, BGBl. I S. 2546, as amended
- Gesetz über das Kreditwesen (Kreditwesengesetz) – Banking Act, re-enacted September 9, 1998, BGBl. I S. 2776, as amended
- Gesetz über den Wertpapierhandel (Wertpapierhandelsgesetz) – Securities Trade Act, as restated on September 9, 1998, BGBl. I S. 2708, as amended
- Handelsgesetzbuch – Commercial Code, dated Mai 10, 1897, RGBl. S. 219, as amended
- Wertpapiererwerbs- und Übernahmegesetz – Acquisition of Securities and Takeover Act, dated December 20, 2001, BGBl. I S. 3822, as amended

Court Decisions

- German Federal Court of Justice (Bundesgerichtshof), decision dated January 30, 1992 (“Siemens/NRG”), NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 1992, p. 1452
- German Federal Court of Justice, decision dated September 16, 1985, NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 1986, p. 118

Publications