

#### THE BIG PICTURE

Germany is China's premier trade partner in the EU

#### HANDLING THE PROCESS

Insights into corporate and public M&A deals in Germany

#### ESSENTIAL BRIEFING

Including regulatory, employment, real estate, banking and finance

# DOING BUSINESS IN **GERMANY**

# Doing Business in Germany

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**ON JANUARY 18<sup>TH</sup>, 2019, CHINESE VICE PREMIER LIU HE CHAIRED THE 2<sup>ND</sup> CHINA-GERMANY HIGH LEVEL FINANCIAL DIALOGUE, AIMING AT EXPANDING THE TWO-WAY OPENING-UP AND DEEPENING PRAGMATIC COOPERATION TO BRING THE CHINA-GERMANY FINANCIAL RELATIONS TO A NEW HIGH. IN THE ENSURING JOINT STATEMENT, HE AND GERMAN VICE CHANCELLOR AND MINISTER OF FINANCE OLAF SCHOLZ, REAFFIRMED THEIR SUPPORT FOR THE RULES-BASED, NON-DISCRIMINATORY, OPEN, INCLUSIVE AND TRANSPARENT MULTILATERAL TRADING SYSTEM WITH THE WTO AT ITS CENTER. ALSO, BOTH SIDES EXPRESSED THEIR COMMITMENT TO ENSURING A NON-DISCRIMINATORY, OPEN MARKET ACCESS ENVIRONMENT AND A STABLE INSTITUTIONAL FRAMEWORK, AND TO EASING EXISTING MARKET ACCESS AND INVESTMENT BARRIERS TO IMPROVE BUSINESS ENVIRONMENT FOR FOREIGN COMPANIES IN BOTH COUNTRIES.**


Many German companies have established enterprises, joint ventures or subsidiaries in China. In recent years, a large number of Chinese companies have invested in Germany – and even more are expected to do so in the years to come.

In undertaking investments, Chinese enterprises often ask questions that go beyond law, such as, to put it simply: “How do we do it?” and “What are the key issues we will face?”.

These questions, amongst many others, are answered in this publication, providing an initial overview of some of the key issues that are likely to be of interest to Chinese entities seeking investment opportunities in Germany.

**Rüdiger Knopf**  
Frankfurt

**Dr. Christian Cornett**  
Frankfurt



# The big picture

## We say...

Germany has always been one of the most admired countries in the world for Chinese people. German technology, products, brands, but also German working style and accuracy enjoy a high esteem in China. In many areas, German products are a “must have” in China: German cars, machines, medicines, kitchen appliances, just to name a few. In the late 1990s, the few initial Chinese investments were focused on machine tooling and machinery producing technologies in Germany. Since 2010, Chinese investors have also made acquisitions in the pharmaceutical, IT, real estate, automotive supply, automation, chemical and aviation industries. Germany is one of the key target countries for Chinese investments worldwide.

Although the relationships between enterprises from the two countries are close and the business environment is good, it cannot be ignored that Chinese investors face difficulties in many areas in Germany. The languages are different, as are the business culture, the way of thinking, not to mention the legal systems. For most Chinese investors, their German investment is their first step outside of China. They need advisors who can provide holistic assistance, spanning commercial, tax, legal and cultural aspects. The KWM German team consists of lawyers from both cultures, some of them involved in Sino-German transactions [continuously] since the early 2000s. We offer to Chinese clients not only legal and tax insights but also understanding of German business, language and culture. In the post-merger phase, we also assist Chinese clients on restructuring, corporate, finance and labour law issues, as well as in many other legal areas.

HUI ZHAO



## Investment environment in Germany

Germany is one of the world's most attractive investment destination due to being

- located in the center of Europe;
- the fourth-largest economy as well as the second-largest exporter and third-largest importer in the world;
- an increasingly close trade partner;
- one of the most technologically advanced countries.

## Chinese investment in Germany

Germany is China's premier trade partner in the EU. In spite of temporary fluctuations, the volume of trade between China and Germany is anticipated soon to reach a total balance of EUR 200 billion p.a. These strong trade volumes are generated by global players from both countries leading in their respective industries.

Against this backdrop it comes as no surprise that both countries are a significant source and destination of foreign direct investment (FDI), as these enterprises look at strengthening their market positions by international M&A activity. Consequently, the number of M&A deals by Chinese investors in Germany has grown rapidly in recent years.

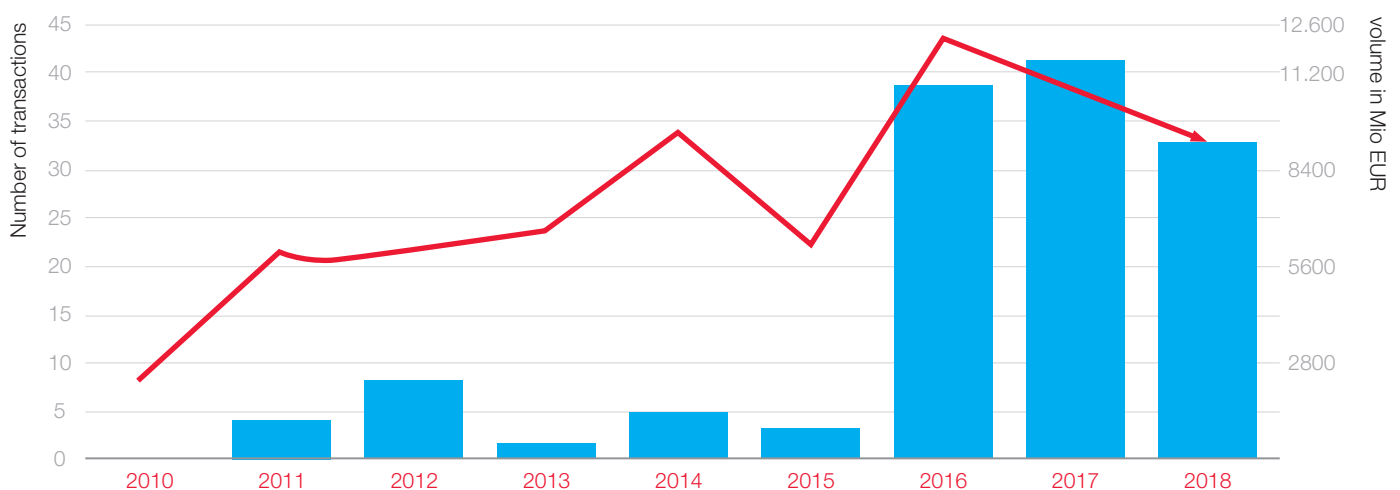
There are numerous examples of successful Chinese investments in the German market. Through successful M&A transactions, Chinese investors have not only gained access to advanced technology, but also to the European market in general.

In 2012, Germany was already among the top global recipients of Chinese FDI, second only to the US, and the long-term trend points towards a further steady growth – in spite of a temporary dip in 2018. The number of Chinese acquisitions of German companies has increased markedly in recent years, from eight acquisitions in 2010 to twenty-five in 2013 and stabilizing at an average of about 35 over the last three years. Germany is thus the most attractive European investment destination for Chinese buyers along with the UK.

**FOREIGN INVESTMENT CONTROL HAS BEEN TIGHTENED IN RECENT YEARS, GIVING GERMAN AUTHORITIES ADDITIONAL POWERS TO REVIEW CERTAIN INVESTMENTS IN CRITICAL INDUSTRIES. NEVERTHELESS, THE GERMAN FOREIGN INVESTMENT CONTROL REGIME REMAINS ONE OF THE MOST LIBERAL IN INTERNATIONAL COMPARISON. WHILE MORE TRANSACTIONS WILL BECOME SUBJECT TO A FORMAL REVIEW, MAINLY AT THE REQUEST OF THE PARTIES, MOST OF THEM CAN BE PURSUED WITHOUT SIGNIFICANT RISK OF REGULATORY INTERVENTION IF TRANSACTIONS ARE PLANNED TAKING INTO DUE CONSIDERATION THE PARTICULARITIES OF THE GERMAN MARKET AND LEGAL ENVIRONMENT.**

**WHILE BOTH TRADE AND INVESTMENT BETWEEN CHINA AND GERMANY WILL ALWAYS BE SUBJECT TO SHORT-TERM UPS AND DOWNS, GIVEN THE SIGNIFICANCE OF BOTH COUNTRIES AS PLAYERS IN THE GLOBAL ECONOMY THEY WILL CONTINUE TO BE SIGNIFICANT FACTORS FOR BOTH ECONOMIES.**

Chinese Acquisitions in Germany (2010-2018)



Source: <https://www.handelsblatt.com/politik/international/internationale-konkurrenz-chinesische-investoren-halten-sich-mit-firmenbeteiligungen-in-deutschland-zurueck/23874988.html?ticket=ST-2304793-dGyp0JbuRrieBupJq-ap5>

- Published amounts in millions EUR
- No of transactions

# Corporate M&A -

# handling the process

## M&A

Many German companies are very interested in Chinese partners and investors. Often, German companies look for entries to the Chinese market and/or Chinese partners for a future co-operation. After hundreds of Chinese investments in - or acquisitions of - German companies, a market practice has developed, a standard that in certain points deviates from other markets: E.g. Chinese investors (and regulators) have come to accept that MAC-clauses (giving a party a right to withdraw in case of a material adverse change) are not market-standard in Germany.

Both German and Chinese regulatory aspects need attention. However, once sufficient transparency on regulatory aspects is established between the German and the Chinese party, in almost all cases the regulatory items can be dealt with swiftly. In a few cases, regulatory considerations require careful consideration at a very early stage of the setup/architecture of a transaction.

## Avoiding cultural misunderstandings in M&A

In our experience, certain cultural aspects have often resulted in Chinese bidders - involuntarily - missing acquisition opportunities in Germany by not observing particularities in the German market, such as timing requirements and the need to manage seller's expectations.

In the German market, most large and mid-market M&A processes (starting at transaction values of even less than EUR 50 million) are conducted as auction processes, i.e. the seller negotiates in parallel with a number of bidders.

- Typically, these processes are led by a financial adviser and strict timing requirements are set by the sellers and their advisers, so they can control the bidding process and achieve an optimal result for the seller.
- Sellers typically value deal certainty very highly, so that it is common in the German M&A practice for the purchase agreement to only contain a small number of closing conditions.
- Certain notarization requirements also need to be observed.

## Timing of M&A transactions

Where the business has been put up for sale, it is important to understand the practice of the (auction) sales process. To avoid missing out on auction opportunities, Chinese bidders should take timing requirements communicated to them in auction processes very seriously. It will often be possible to side-track the auction process, in particular where the timing issue is addressed very early in the process. One example is the signing of a non-disclosure agreement at the outset of the auction, which should preferably not take more than 2-3 days. In addition, Chinese bidders should, at an early stage, take all preparatory measures with respect to governmental approvals.

### We say...

In Germany, M&A processes are usually professionally organised and potential investors are expected to play by the local rules. Knowing such rules and seizing opportunities when they occur is key to success. Therefore, for a foreign investor, it is crucial to have experienced and trusted advisors who are familiar with the local rules while also understanding the investor's background and strategy.

**DR. SANDRA LINK**

In other cases, it is important to invest time in understanding the German entity and the seller(s) before deciding on the M&A approach. It is often necessary to build a relationship with the relevant individuals at the target and to demonstrate a real interest. In particular, owners of family-controlled German businesses generally need time - and sometimes a certain degree



of motivation - to come to a decision on a transaction. While for the majority of German businesses, and not just those held by private equity, M&A transactions have become a familiar process, for some other sellers such transaction is a once-in-a-lifetime project. Implementing deals successfully still largely depends on taking into account the particularities of the German market.

Notably, purchasers or merger partners should familiarize themselves with the relevant options, including legal and tax aspects relevant to all sides of the transaction, before deciding on deal structures and other aspects. This applies above all to public M&A and, to some extent, to investments in public companies (PIPEs).

## Deal certainty

Traditionally, it is common in the German M&A practice for the business purchase agreement to contain a small number of closing conditions. Sellers typically value deal certainty very highly – in some cases even at the cost of accepting a slightly lower purchase price. While this tradition may have cultural roots, it is paramount to be clear that in a number of areas, such cultural-based traditions have to be understood to sign a deal.

- Since deal certainty has such a high priority, sellers will not usually accept a large number of conditions for completion.
- If all closing conditions have been satisfied and a party is still not fulfilling its obligations under the SPA at closing, the other party may either claim damages or demand specific performance. The latter means that the breaching party remains bound by the agreement and can be forced by the court to perform under the agreement (i.e. the other party is not restricted to claiming damages).
- It is not uncommon that a seller chooses a buyer that seems the most likely to perform – even if other bidders have made slightly higher offers.
- To the extent that the performance of an agreement is subject to regulatory approval in China, Chinese buyers are at a natural disadvantage and need to take time and invest resources to

inform the seller about the approval process and thus to build trust.

- Foreign investment control clearance is advisable and typically requested by the seller where a Chinese investor acquires 25% or more in a German company (or 10% or more in a German company in a critical sector). This needs to be taken into account in particular with respect to timing. That being said, for well above 90% of all transactions is a procedural item rather than a substantive obstacle.
- So-called break-fees (amounts to be paid by the investor to the seller(s) if certain closing conditions are not fulfilled) in the range between 5% and 15% of the purchase price (most often in the lower range) have become market practice in Sino-German transactions. As, however, almost all transactions once agreed on are subsequently closed, the break-fee provision is typically not an actual expense for the buyer, but rather an instrument to increase the level of deal certainty from the seller's perspective. By now, although still a heavily negotiated point, this is typically dealt with by way of a bank-guarantee, and usually not a deal-breaker.

## Notarization

In most cases, the German target is organized as a German limited liability company, a so-called GmbH. This is a legal form with high flexibility but also some peculiarities, such as a notarization requirement. The notarization serves to ensure that the parties are fully aware of the significance of the transaction and is thus typically perceived as an anachronistic formality in transactions where both sides are represented by experienced lawyers. Whether needed by the specific parties or not, it is a mandatory requirement and a perfect illustration of the German particularities that need to be understood in order to enter into a successful M&A transaction.

Actions requiring notarization include the sale and transfer of shares in a limited liability company (but not shares in other types of entities), any sale and transfer of real estate, any revision of the articles of association of a limited liability company as well

as certain important shareholder resolutions, e.g. regarding the issuance of shares or a statutory merger, all have to be notarized.

Notarization is costly, with an SPA on the sale of a limited liability company with a value of EUR 100m running to approx. EUR 80k (if the deed is in English). During the notarization process in Germany, the notary reads out the entire document (including all relevant annexes) to the parties who have to attend either in person or to be represented by a legal representative.

If notarization requirements are not met, the legal act is void and cannot be enforced. It should, thus, be ensured at an early stage that all prerequisites for a timely notarization are fulfilled.

Further, certain corporate measures have to be filed with the commercial register. Relevant changes, such as an amendment to the shareholding in a limited liability company, alterations to the articles of association, the appointment of a managing director as well as any other important corporate measures, have to be registered or filed with the competent local commercial register. Since some of these measures require registration to be valid, it is always important to apply for registration in a timely fashion to avoid long periods of uncertainty.

## Public M&A

While any investment in German entities is quite straight-forward when structured well, an investment in a listed German entity is, from an investor perspective, often particularly appealing as it gives investors the opportunity to invest in tranches.

Such a PIPE (private investment in public equity) transaction needs to be structured and timed somewhat different from a private M&A transaction, and certain market standards should be complied with (e.g. limited due diligence, a staggered control over management, insider rules). As in any market, certain German market standards have developed for such transactions and such PIPE transactions are often implemented in a very successful manner for both sides. From the seller and/or listed entity's perspective, such PIPE transactions (e.g. block trades and / or investments against issuance of new shares) provide quick access to equity capital at acceptable transaction costs. And, beyond the option to increase the stake, the investor has a liquid investment which potentially does allow for a face saving exit, often implemented in a staggered way.

In the German market, standard approaches to PIPEs such as share subscriptions, block trades and public tender offers have evolved that should be observed by foreign investors. That does not mean that there is only one way to implement public M&A

### We say...

As evidenced by a number of significant Chinese investments in German listed companies (such as inter alia Daimler or Kion or many others), Chinese investors are by now recognized as valuable stakeholders by a large number of German listed companies. Minority stakes often grant a valuable strategic entrance for clients. On the backdrop of the increasingly seamless co-operation with our Chinese colleagues in a number of Chinese investments in German listed entities, the Frankfurt based KWM team's knowledge of the German market as well as the German regulatory environment together with KWM's Chinese lawyers' in-depth knowledge of the Chinese regulatory situation and clients' needs, KWM's combined team is able to optimize the outcome for the benefit of our clients.

**DR. CHRISTIAN CORNETT**

transactions. Certain elements, however, are now accepted in the market as best practice, and overall, the process - in spite of some German particularities - has been assimilated to the process in other jurisdictions.

### Takeover offers

Under the German Takeover Act, a purchaser is obliged to make a mandatory takeover offer if he gains direct or indirect control over the target company, which is the case if he holds at least 30% of the voting rights in the target company. Both for mandatory and voluntary takeover offers, there are strict rules as to the purchase price for the shares. The purchase price has to be "appropriate" and is calculated based on the average market price of the shares or the price paid earlier by the bidder.



# Finance regulatory

Investments in the financial sector are subject to specific clearance procedures. This applies to acquisitions of stakes in banks, investment firms, fund managers and insurance companies (financial sector entities). The critical threshold which triggers a need for regulatory clearance is 10% of the shares or voting rights of the relevant target. Furthermore, clearance procedures are also required in case a previously cleared stake in a financial company is increased above certain levels.

Clearance needs to be sought from the German Financial Services Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin), the single regulator for the financial sector in Germany. In the insurance sector, BaFin is the only authority involved in this process. For most banks, on the other hand, under the EU's Single Supervisory Mechanism, the clearance decision is made by the European Central Bank (ECB); also, during a procedure relating to any bank, BaFin is assisted by the local branch of the German Federal Bank (Deutsche Bundesbank) in the area where the target is located. It should be noted that the obligation to inform BaFin is already triggered by the intention to acquire a relevant shareholding (i.e. prior to the actual acquisition) and also that several persons acting in concert can require notification where each such person, individually, does not reach the threshold. The procedures start with the filing of notification which normally involves considerable paperwork to describe the background of the acquirer, the acquisition and (to a certain extent) the intention behind the acquisition.

Only once BaFin has concluded that the filed notification is complete will a corresponding confirmation be issued to the acquirer. From the date of this confirmation, there is a certain period of review which, in the case of an acquirer from outside the EEA, such as China, is 90 business days and during which BaFin may raise any concerns or approve the intended acquisition.

Pursuant to the rules governing the clearance procedures, BaFin may raise concerns against the intended acquisition (and indeed prohibit the acquisition) if, for instance, it comes to the conclusion that

- the acquirer or its legal representatives are not reliable or for other reasons not able to manage the target in a strong and prudent manner (which is, among other things, the case if the

## We say...

German law generally does not distinguish between German and foreign nationals when reviewing investments or the establishment of companies. Given the importance of financial institutions for the economy as a whole, however, the review process for investments in this sector is detailed and elaborate. It requires good understanding of all applicable requirements to allow for pro-active communication with the relevant authorities.

**RUDOLF HAAS**

funds used for the acquisition are from illegal sources);

- the target will not be able to meet the supervisory requirements resulting from the relevant European directives and regulations or becomes part of a group of entities which, by its very structure or lack of transparency, can adversely affect supervision of the target;
- the acquirer does not have the financial substance to support the capital requirements and liquidity of the target; and
- a non-EEA acquirer is not subject to effective supervision in its home country or is domiciled in a country where the regulator does not cooperate with BaFin in a satisfactory manner.

Where the ECB is the relevant authority to render the ultimate decision, BaFin will prepare a recommendation, which the ECB usually follows.

In our experience, ultimately, the clearance filing will be successful if the relevant authority can be convinced of the substance and reliability of the acquirer and of the availability of the funds which are used for the acquisition (and, if applicable, capitalization of the target).

Outstanding clearance does not per se prevent the acquisition from being implemented (by a transfer of the shares in the target), but the parties run the risk of the ECB (or, where applicable, BaFin) prohibiting the acquisition retroactively and ordering the shares in the target to be only transferred with its consent forthwith. In such a case, BaFin may also apply to the competent court for the voting rights attached to the shares in the target to be transferred to a trustee, with the trustee being instructed to sell the shares in the target to a sound and reliable third party. Finally, non-compliance with the clearance filing requirements is an administrative offence which can be sanctioned by a fine of up to EUR 200,000.

Against the backdrop of these far-reaching consequences and considering the uncertainty surrounding the end of the clearance period, it is advisable to contact BaFin and Deutsche Bundesbank sometime prior to the "official" clearance filing to discuss the proposed transaction.

# Taxation and deal structuring

## The national tax system

As most Western countries, Germany has a rather complex and detailed tax system, with a wide range of legislation as well as decrees from fiscal authorities and jurisdictions of the fiscal courts.

Individuals are subject to income tax at a progressive rate, with a maximum tax rate of 45% for their global income if resident in Germany. Otherwise, only specific German-sourced income will be taxed. A solidarity surcharge of 5.5% of due income tax is also applicable. Where the individual runs a business, trade tax will be levied, which depends on the community the business is located in given that every community has a right to determine a municipal factor. Currently, the rates range from 7% up to approximately 19%.

Corporations are liable for corporate income tax at a flat rate of 15% for their worldwide income if they are resident in Germany or for specific German-sourced income. The solidarity surcharge and trade tax apply as well. Given this, the overall effective tax rate for a corporation usually lies somewhere between 27-30% but might actually deviate significantly from this range.

Partnerships are transparent except for trade tax purposes, i.e. any partner will tax his profit share individually in accordance with his own tax regime but the partnership itself will pay trade tax if applicable.

Subject to tax will be the net income, i.e. profit as a difference between income and expenses. For this, the financial statements under German GAAP can act as a starting point. Several exceptions apply in terms of the tax balance sheet. In addition, some expenses are not deductible; the most important ones being expenses in breach of the arms' length principle and certain interest expenses.

Germany no longer has any net asset tax except for the property tax on German real estate.

As in most countries nowadays and especially within the EU, deliveries of services and goods might be subject to value added tax (VAT). The normal German rate stands at 19% and is usually added on to the net sum. The tax will normally apply at every phase of a delivery and might also occur in the case of imported goods and services rendered by a foreign provider. However,

value added tax paid by an entrepreneur to a supplier might be credited against his own VAT payment.

Finally, Germany levies real estate transfer tax (often referred to as "RETT") for the transfer of German property or for qualified transfers of companies owning German real estate. The latter regulations, in particular, require careful attention as these do not only apply to the direct acquisition of such a company, but also for indirect transfers including those within a group. The tax rate depends on the federal state the property is located in, as any given state has a right to assess its own tax rate. Currently, the rates range from 3.5% up to 6.5%.

## International aspects

Foreign investors might be subject to income taxation for specific German-sourced income, especially arising from a permanent establishment or the rental of German property.

Additionally, withholding taxes will be assessed. Whereas, under domestic law, interest is normally not subject to withholding tax, dividends and licence fees might trigger withholding taxes of 25% plus a solidarity surcharge of 5.5%, leading to an effective tax rate of 26.375%.

However, Germany has concluded double tax treaties with almost 100 countries which usually reduce such withholding taxes significantly. For instance, the Sino-German double tax treaty only allows for a withholding tax for licence fees of 10% (or 6% in certain scenarios) and for dividends of 5% for a qualified shareholder or 10% for almost any other shareholder. (Please note, that companies in Hong Kong or Macau are not within the scope of and as such are not protected by the double tax treaty). Moreover, EU directives might lead to any withholding taxes being reduced to zero. In this context it should be noted that Germany has very detailed anti-abuse legislation, which can make accessing those benefits sometimes rather difficult.

Germany does not levy a branch profit tax.



### We say...

Chinese investors thinking about investing in Germany will be able to achieve an attractive and tax efficient investment structure when utilising professional tax advice from the very outset of their plans to invest into Europe.

**MARKUS HILL**

## Agenda to avoid tax issues

There is no way back from any tax leakage, once the documentation has been signed or a transaction has been implemented, and the facts have thus been established. Therefore, it is of utmost importance to check the tax consequences of any action in advance.

Given this, most of the following items should usually be on the agenda to be reviewed and discussed properly, and the structuring should be done accordingly:

- subject matter of an acquisition (share deal or asset deal; from a tax perspective, the acquisition of a partnership is equal to an asset deal);
- analysis of the German business to be operated or of German companies already owned;
- financing of an acquisition or a group (equity, shareholder loans, bank debt) considering tax deductions but also legal restrictions and balance sheet effects;
- minimisation of transfer taxes, e.g. avoidance of real estate transfer tax;
- reorganisations (post-closing or for existing groups) to streamline organisational needs without triggering adverse tax effects and to improve the tax position (e.g. for interest deduction);
- optimised repatriation of payments (dividends, licence fees, interest);
- effects on financial statements; and
- cash flow considerations.

As a cross-border investment also effects at least one other tax jurisdiction, it is essential to incorporate these effects into tax advice.

## Subsidies and grants

In Germany, investment incentives are usually provided by the German federal government, the German federal states and/or the European Union. Whether cash incentives, interest-reduced loans, public guarantees, labour-related incentives and/or R&D incentives: in general, these grants are available to all companies and investors, including enterprises acquired or held by Chinese investors, provided that the investment is beneficial to the German economy.

These subsidies are often administered by the nationally operating German development bank (KfW) or German or EU authorities. In a number of deals, our understanding of the mechanisms behind the subsidies and grants have proven to be vital for the success of the transactions.

Tax breaks or tax free zones are usually not available.

# Banking and finance



## Structuring the financing of your investment

In funding an acquisition in Germany, investors regularly use both equity and debt instruments. With respect to the debt capacity of the target, investors need to be aware that lenders will base their credit decision - along with other criteria, such as the security position of the lenders - on the cash flows projected for the coming years. In addition, investors will need to take into account the ratio between debt and EBITDA (Leverage) when structuring the financing.

There is no general rule as to potential leverage levels in an acquisition scenario since they mainly depend on the overall market situation and the projected cash flow of the target group. However, in the current market situation, we often see senior leverage levels above 4.00x and 5.00x EBITDA. Many German banks are, due to restrictions imposed by the European Central Bank, not able to provide loans in such scenarios. Often, in highly leveraged transactions sponsors therefore borrow money from alternative debt providers, like special debt funds (also known as "Unitranche"-financings).

In an acquisition scenario, there are various types of potential debt instruments available to finance the purchase price.

In the German market, the debt structure usually consists of senior bank term loans as a center piece, which can be complemented by junior finance instruments (mezzanine or - even less likely - second lien instruments). The question as to whether mezzanine or second lien debt is required (but also available) for financing will also depend on the leverage level, given that bank lenders are often reluctant to exceed certain leverage levels - in the current market these junior pieces are rare. As said above, with the additional funding option provided by debt funds, in many of such highly leveraged financings Unitranche-financings - either coupled with a senior financing or, more likely, a super senior revolving credit facility (e.g. for general corporate purposes) or separately - are very common. Typically, the Unitranche facilities also have a longer average lifetime and, hence, they often combine senior and mezzanine elements.

High-yield bonds are also fairly common in the German market, although they are rarely used in transactions where the financing volume is below EUR 200 million, and are more likely to come into play to refinance an acquisition post-closing.

From an investor's perspective, it is key to find a financing solution that is suitable for the financing needs of the target entity. In this respect, investors should not only consider the funding of the purchase price for the investment, but also the financing of working capital needs and potential capital expenditure and add-on acquisitions.

## Documentation

In Germany as well as in the rest of Europe, facility agreements are commonly based on, or at least aligned to, the standard facility agreements prepared by the Loan Market Association (LMA) in London. The LMA-based facilities agreement for leveraged transactions is a sophisticated document serving as a starting point in negotiations with lenders, which will - in German transactions - be amended to comply with German law.

The language of the facilities agreement largely depends on the composition of the lenders and the syndication strategy. In large transactions where lenders from different jurisdictions participate in the transaction financing, the facilities agreement will often be in the English language as a means of facilitating the syndication process. However, in particular in mid-market transactions, where the lenders are domestic banks, the German language is commonly used.

Where the financing structure consists of different layers of debt (e.g. super senior revolving credits, senior debt, bonds and shareholder loans), it is common practice to govern the relationship between the creditors in an intercreditor agreement. Such an agreement might also be based on, or aligned to, the standard intercreditor agreements prepared by LMA. It provides for the ranking between the different debt layers and the application of potential enforcement proceeds, as well as usually being governed by German law.

The provisions of an intercreditor agreement, in particular, become increasingly important in a distressed scenario. In order to find a suitable solution, it is essential to conduct a thorough analysis of the impact of the provisions of the intercreditor agreement.



## Exit considerations

Given that facilities agreements generally contain a change of control clause, the investor needs - in an exit scenario - to factor in the repayment of existing financial indebtedness under the financial documentation.

Under German mandatory law, a borrower may repay a loan with a variable interest rate at any time at the end of each relevant period for which the variable interest is fixed, in each case without having to pay prepayment or breakage costs. Investors, therefore, generally seek to repay existing loans at the end of an interest period to avoid breakage costs, which might be substantial in the case of long-term financings.

If letters of credit were issued under an existing facilities agreement and are still outstanding upon repayment of the facilities, these letters of credit have generally to be returned to the issuing bank or cash collateralised. Alternatively, the purchaser's lenders could replace outstanding letters of credit, which is often highly complex and time-consuming, or guarantee the outstanding letters of credit in favour of the existing lenders by assuming a back-to-back guarantee (Rückavalierung).

An exit not only requires thorough preparation on the M&A side, but also with respect to the existing financing. Refinancing options should be discussed and taken into consideration at an early stage.

## Does German law contain prohibitions on financial assistance?

A German stock corporation (AG) is prohibited from granting financial assistance (including granting of security) for the acquisition of its own shares, and such a transaction would be void. In addition, the granting of security for a shareholder obligation is viewed as repayment of share capital, which is only permissible subject to certain limitations, which are based on a balance sheet test.

## Does German law allow compound interest?

Under German law, a debtor may not agree in advance on any compound interest or to pay interest on due interest. Therefore, if a facilities agreement is governed by German law, such an agreement regularly provides for lump sum damages (pauschalierter Schadensersatz) accruing on the overdue interest amount from the due date.

## Does German law allow upstream or cross-stream guarantees or security interests?

The granting of guarantees or other security interests by a German limited liability company (GmbH), a German stock corporation (AG) or a limited partnership with a general partner that is a GmbH or another company with limited liability is permitted in general. However, German capital maintenance rules provide that the share capital of the company may not be repaid to the shareholders. The granting of a guarantee or other security instrument for the borrowings of the parent or sister companies (i.e., upstream security or cross-stream security) qualifies, under certain circumstances, as a prohibited repayment of share capital. Since a breach of such rules can result in criminal and/or personal liability of managing directors, it is common practice to limit and restrict the enforcement of the guarantee or security instrument contractually by inserting so-called "limitation language".



# Employment

## Overview

Employment law is very strict and highly regulated in Germany which often comes as a surprise to foreign investors.

## Collective employment law

Employment relations are not only regulated by employment agreements negotiated between the parties, but also by agreements between the trade unions and individual employers / the employers association and by agreements between the works council and the employer.

A works council is elected by the employees of a company. It has to be consulted when hiring or dismissing employees. They have a number of co-determination rights, for example with regard to holiday roster, working time regulation and remuneration structure. The works council also needs to be involved when a company is restructuring its business. A works council cannot prevent a restructuring process, but can delay it considerably.

A trade union is an organization typically formed by the employees of one industrial sector (e.g. metals, chemicals, pharmaceuticals etc.). They collectively negotiate employment conditions for their members (e.g. salary, working time) with the respective employers association or individual companies directly.

The trade union has a right to call for a strike in order to enforce its demands, for instance to obtain a pay rise for its members.

Good management of collective labour relations is the key to a successful investment.

### We say...

Employment law can be a significant element of a transaction. While advising our clients on acquisitions and acquisition structure we always consider potential employment law consequences and effects for the employees, the company and the investor.

**CHRISTIAN OSTERMÖLLER**

## Individual employment law

German employment law has very strong termination protection. Depending on the size of the company, the employer will not be allowed to dismiss an employee unless he can justify the dismissal based on a number of reasons acceptable by law. Any lay-off or redundancy should therefore be strategically planned in advance.

## Acquiring employment relationships

If an investor acquires a business in Germany, he will acquire the respective employment relationships including any employment conditions agreed with the employees. Employees may object to the transfer of their employment relationship within one month of being informed about the future transfer. The employment conditions may not be changed unilaterally by the new employer.

## Social security

The burden of social security is shared between employer and employee. Pension, unemployment, health and nursing care insurance are shared between employee and employer. Roughly 20% of the employee's gross salary will have to be paid by the employer on top, limited roughly to EUR 1,000 per month and employee. Every employer has to pay contributions to an accident insurance. Each industry operates its own scheme and the amount contributed varies from industry to industry depending on the frequency of accidents in that industry. In return, employees cannot claim any damages from the employer even if the work-related accident occurred due to gross negligence on the part of the employer.

Where, in the context of a project, establishment of a business or a joint venture, special expertise is needed, we closely co-operate with other specialised law firms and other experts in a seamless manner for the benefit of our clients.

Such seamless collaboration with other advisors in Germany or other jurisdictions forms a natural part of our daily work. We are equally used to leading such collaboration and providing expert input to projects led by other advisors.



### **Will I need the consent of employee representatives to acquire a business in Germany?**

The consent of the employee representatives is generally not required; however, the employee representatives will have to be informed about the intended transfer before it happens.

If a part of the business is sold, only the seller will have to consult the employee representatives.

Until this consultation procedure has finished, the business cannot be split up and, therefore, the seller will not be able to transfer the business.

The duration of this consultation procedure can vary significantly depending on the circumstances. It can be completed within a few weeks or it may even take three months or more.

### **Will I have to negotiate with a trade union if I acquire a business in Germany?**

Legally, the trade unions do not have to be involved in any transaction. However, in very large transactions, the trade unions will try to negotiate certain guarantees, such as site guarantees or job guarantees for the employees. This will mostly be done by informal “gentlemen agreements”.

Even though such agreements are not enforceable, it would be unwise to ignore them completely.

### **Are strikes common in Germany?**

Trade Unions are allowed to call for a strike when they negotiate collective bargaining agreements.

They may e.g. call for a strike while they are negotiating in order to make it clear that they are willing and able to mobilise their employees. Although trade unions frequently threaten to call for a strike, in most cases an agreement is reached before a strike actually happens.

### **Once I have hired employees, will I be able to dismiss them?**

German employment law is very protective of employees. Employment relationships at companies with more than 10 employees can only be terminated if the employee is no longer capable of performing the required duties (for reasons related to the person), if the position becomes redundant, or if the employee has violated any contractual obligations.

In the latter case, under extreme circumstances, the notice period is dispensable (summary dismissal). Normally, the employee needs to receive a formal warning and be given time to alter his/her behaviour. If the employment tribunal comes to the conclusion that the notice was not legally justified, it will be declared null and void and the employee has a right to be reinstated.

This will often mean that the employee will have the right to claim payments for the time during which he/she was prevented from working.

### **If I want to make an employee redundant: do I need the permission of the works council?**

If a works council does exist at a company, it has to be given a hearing with regard to every intended notice. The works council has a week to discuss the notice and will then give the employer its view. Even if the works council objects to the notice of termination, the employer may go ahead nonetheless. However, in this case, the employee has the right to be employed even beyond the notice period until a court has decided whether the notice is legally effective or not.

# Intellectual property



## Overview

Germany is an attractive country to investors hungry for technology and seeking to compete in high-end manufacturing. This is an area where Germany has extensive resources. The German Mittelstand, the mid-size companies that form the backbone of the German economy, are often global leaders in their respective niches, and Germany's strength in fields such as engineering is outstanding.

With a relatively conservative and disciplined approach, Germany is an excellent market for investors who pay increasing attention to the security of their investments, and ever more strategic investors look to use German companies as launch pads for expansion in Europe.

Generally, in a fast-moving world, corporate assets have become increasingly intangible and IP assets are often at the core of investments.

## Intellectual property in corporate transactions

Particularly in transactions where IP is the very essence of the target, it is crucial to identify and resolve issues relating to intellectual property rights at an early stage. IP as an asset requires critical due diligence, taking into account multi-jurisdictional issues as well as corporate, regulatory, antitrust and tax law in order to develop an appropriate structure and integrated portfolio strategy. Cross-border transactions with multinational companies require particular in-depth due diligence of the additional regulatory issues inherent in such transactions.

In transactions that rely heavily on IP, it is crucial to prevent a disappointing outcome and to undertake any measures to make sure that all relevant assets are with the target and fully transferred, and that appropriate licences or transitional services are put in place. However, there are some very easy precautions that can and must be taken to ensure a satisfactory outcome for an IP transaction.

When special expertise is needed, we closely co-operate with other specialized law firms and other experts. Obviously, many clients prefer us to work with their own auditors or other chosen experts in areas such as IP, environment or employment to enact a global strategy in such areas. We typically either include or take into adequate consideration such expert input in our work products.

## Important tips

- Be aware of what you think you are buying, in particular what IP rights you obtain;
- Be sure about the relevance of the IP rights and those rights you are focusing on;
- Discuss the relevance of the IP rights with your IP counsel;
- Undertake a due diligence and understand what you actually buy;
- Ensure that the seller is the owner of the IP rights (no sharing with or licensing from group companies that are not part of the transaction!) and entitled to sell them;
- Undertake an independent search on the ownership of the relevant IP rights and their history to ensure that the rights lie with the seller and are still in force;
- Procure details of all deadlines relevant to the IP rights, such as renewal dates and term of licences;
- Check whether there are any encumbrances on the IP;
- Verify whether IP rights are subject to cancellation action or infringement suits;
- Request information from the seller as to whether there are any IP rights or other circumstances that may affect the use of the IP rights you buy (prior rights, co-existence agreements, settlements etc.);
- In multi-jurisdictional transactions involving IR (international registrations), pay attention to possible limitations to ownership under the Madrid Agreement and the Madrid Protocol;
- Request details of any improvements of patents;
- Identify relevant know-how;
- Check whether the transfer or license of rights is exclusive;
- Cross-check that the result of the IP due diligence meets the expectations you identified.

# Real estate

## Overview

Germany is one of the world's most stable and popular locations for property investors owing to its positive economic outlook, solid labour market and rental opportunities in top office centres and prime shopping locations.

Like everywhere else, acquiring real estate requires local expertise. The final due diligence report provides an executive summary setting out the major findings clearly, particularly useful for clients from China and other foreign jurisdictions, given that Chinese property law is quite different from German property law.

Real estate aspects are not only relevant for direct/indirect real estate investments but also for M&A transactions. The property ownership rate of German companies is 70% on average, especially where the target company has a great need for land, e.g. if it operates in the manufacturing industry or logistics sector. Thus, identifying legal pitfalls and offering efficient and sustainable real estate solutions are essential for transaction success.

## Ownership

The first question foreign investors usually ask is:

### Who can own real estate in Germany?

In Germany, all individuals and legal entities with legal capacity, irrespective of whether resident or non-resident, can invest in real estate and become an estate holder. Unlike some of the other European countries, there are no legal restrictions for Chinese investors in Germany.

Due to the formal land registry law, real estate investments in Germany – as compared to European and international standards – are characterised by a high level of legal certainty. The review of title forms an important factor in any real estate transaction.

The most common form of title in land in Germany is freehold, i.e. the freeholder has complete control of land and buildings with no time limitation. Depending on the legal implementation of the transaction, German law differentiates between sole ownership, co-ownership and joint ownership.

Other forms of ownership are, for example, the hereditary building right, according to which the beneficiary acquires the alienable

and inheritable right to own a building on or below the surface of land for a certain period of time. The ownership of land as well as the hereditary building right can be encumbered with servitudes, mortgages, land charges and other rights in rem. All premises in Germany and any encumbrances are recorded in the land register, which is kept at the local courts.

## Leases

Leases have a material impact on the success or failure of an investment in Germany. If the investment is based on the cash-flow generated by leases, the validity, duration, rent and credit rating of the tenants are the key factors for the profitability of the investment. If the essential production locations of the target company are held via leasehold, the unexpected termination of a lease can endanger the economic foundation of the target company.

## Sale and Purchase Agreements (SPA)

Under German law, agreements relative to the conveyance of property need to be officially recorded before a notary. By law, the notary is obliged to act impartially and ensure that the conveyance complies with statutory law. A fundamental element of notarization is the reading out of the sale and purchase agreement by the notary. After the reading procedure, the sale and purchase agreement needs to be signed by the parties and the notary. Without notarization, the agreement would be void.

A sale and purchase agreement is a complex contract containing all relevant provisions, e.g. payment of purchase price, representations and warranties, guarantees, caps, limitation periods, costs and financing.

Usually, a sale and purchase agreement is drafted by the parties using their own external advisors who ensure that their client's legal interests are upheld.

Typically, the cost of notarization and registration of the title transfer in the land register is borne by the buyer. The costs for advisors (legal, technical and any other) are borne by each party individually. As a rule of thumb, for commercial property transactions, fees for notarization and implementation of the conveyance amount to about 1% of the purchase price.

KWM's team in Germany has handled all kinds of transactions as well as establishing of new business setup, joint ventures etc. In case that in the context of a transaction, establishment of a business or a joint venture specific real estate expertise is needed, we closely co-operate with other specialised law firms and other experts in order to achieve the best possible result for our clients.

# Regulatory aspects

In Germany, regulatory aspects can typically be handled very smoothly. Unlike some other jurisdictions, most investments in Germany do not call for substantial regulatory issues to be addressed. For example, subject only to a few exceptions and notification requirements, Germany does not generally restrict the export or import of capital.

There are, however, a few areas which do require attention, and the following issues are those we typically address in the context of Chinese investment in Germany.

## Merger control

Acquisitions will require notification to, and clearance from, the German competition authority, the Federal Cartel Office, if (1) they qualify as reportable concentrations, and (2) the parties meet certain turnover thresholds.

## Concentration

The German Competition Act lists several transaction scenarios which qualify as concentration. The most important scenarios are the following:

- Acquisition of control: this scenario is met where the purchaser acquires a majority of the shares or voting rights in a target company and is, therefore, able to define the operations of the target company. Minority shareholdings (below 50%) can qualify as acquisitions of control where the purchaser has veto rights in relation to key strategic business decisions of the

target company;

- Acquisition of shares: this scenario is met where the acquisition results in the purchaser crossing one of the thresholds of 25% or 50% of the capital or voting rights in a target company.

## Turnover thresholds

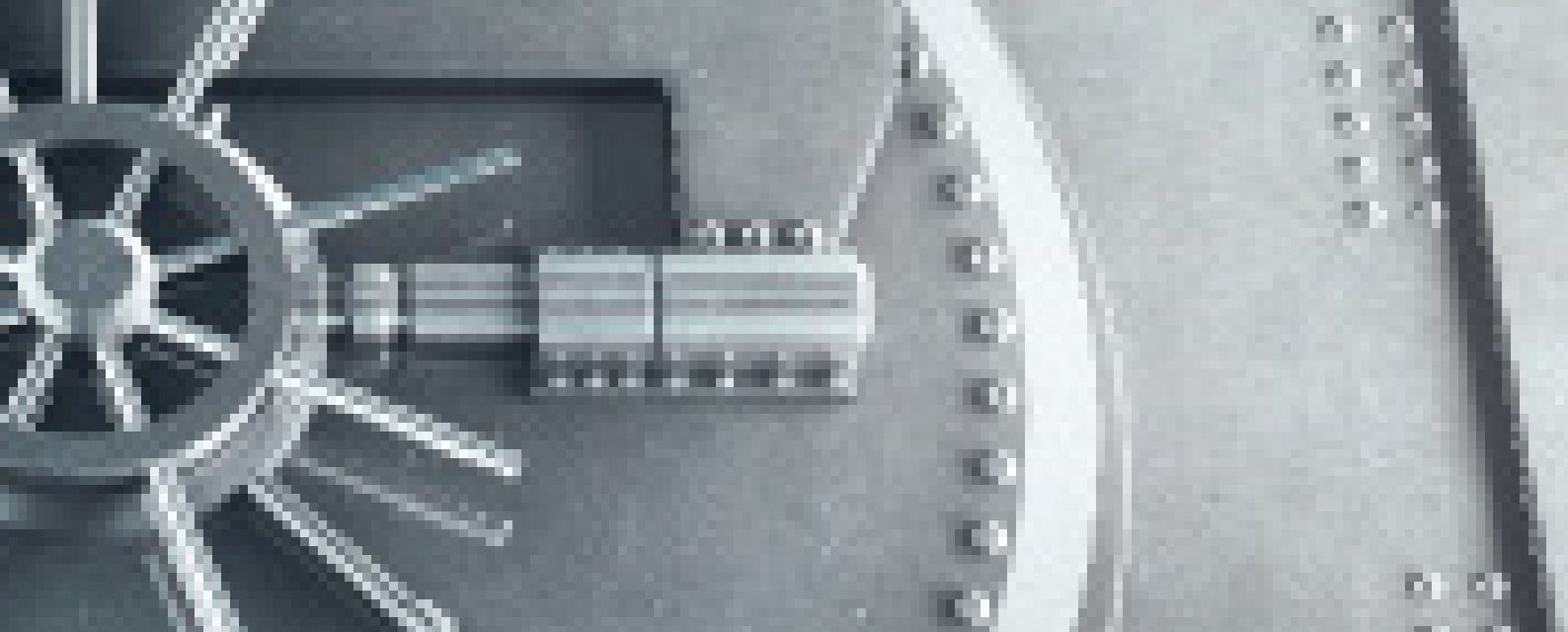
In general, concentrations will have to be notified if the parties meet the following cumulative turnover thresholds:

- The parties' combined worldwide turnover exceeds EUR 500 million; and
- One of the parties (acquirer or target) has national turnover in Germany of more than EUR 25 million; and
- The other party (target or acquirer) has national turnover in Germany of more than EUR 5 million.

If the (higher) turnover thresholds triggering merger control clearance at the European Level are met, competent authority for merger control clearance will be the European Commission and not the Federal Cartel Office.

In the context of many projects, specific legal expertise with regard to regulatory aspects is needed to meet the client's needs and their global strategy, e.g. in the form of national or EU merger control advice or specific competition counsel in other jurisdictions. In these cases, we work seamlessly with our offices in Brussels, Beijing or in the other jurisdictions in which we practice, as well as with experts in best-friends firms in those where we do not. We also co-operate closely with specialised law firms, investment banks, auditors and other advisors in Germany or other jurisdictions to get the client's deal done.





## Foreign direct investments

While the German merger control rules focus solely on the competition aspects of transactions, investments in German companies by non- EU/EFTA investors such as Chinese investors can also be reviewed by the German Ministry of Economics with regard to their impact on German national public order and security.

As the total number of Chinese investments in German enterprises has grown considerably over the last years, the relevance of this foreign investment control review has evolved in parallel. The scope of relevant provisions has been extended during the last years with further changes expected to come.

The table below sets out a short overview of the key aspects of this procedure:

	Military (defense and arms)	Critical business	Other business
Personal scope	All foreign investors	Non-EU / EFTA investors	Non-EU /EFTA investors
Threshold	10% of voting rights	10% of voting rights	25% of voting rights
Suspension of closing by law	Yes	No	No
Notification obligation	Yes	Yes	No
Preliminary procedure	No	Yes	Yes
Potential timeline (approx.)	4-8 months	2-8 months	2-8 months

As most transactions concern a non-military business, the parties often initiate a preliminary procedure applying for a certificate of non-objection to achieve legal certainty, i.e. confirmation that the Ministry will not intervene. Unless the

Ministry opens a full review, such confirmations can be obtained within one or two months, and this process will often be conducted in parallel to the merger control proceedings. A recent tightening of the relevant rules, has resulted in more reviews being initiated by the parties and longer review periods being available to the regulators. While this may impact the timing of a transaction, there are hardly any cases that are not approved.

Beyond Germany, the European Union has recently adopted a new regulation establishing a framework for the screening of FDI into the European Union (FDI Regulation). It is the first ever EU level tool to screen FDI on grounds of security and public order. A key development is that FDI Regulation now sets up a cooperation mechanism between member states and the European Commission, determines certain screening factors and specifies which information should be made available as part of the cooperation. Despite the additional cooperation mechanism, member states will retain the power to review foreign direct investment on national level.

### We say...

In line with a global trend of increasing protectionism and a more critical approach to foreign investments, the regulatory environment in Germany has recently been tightened and further adaptations have to be expected going forward. However, these aspects remain manageable in the vast majority of foreign investments, provided that the specific transaction is prudently prepared and structured. Experience from past transactions can prove to be a material advantage when assessing the key items for a regulatory proceeding so that necessary clearances can be obtained in due time.

**DR. TILMANN BECKER**

# Seamless

# co-operation

## Sino-German projects

Our combined team has extensive experience in the handling of all kinds of issues that arise in the context of Sino-German transactions and projects, e.g. unexpected regulatory requests, complex internal approval processes, the need for explanatory memos on regulatory items and providing legal opinions on dealing with authorities in China as well as all other aspects of Sino-German transactions, including cultural aspects.

The seamless and trust-based co-operation between the members of the KWM team in various jurisdictions has in the past proven to be of substantial benefit for our clients and often been of decisive help in the context of successfully executing Sino-German transactions and projects. Our one-team approach is founded on personal experiences, including a string of mutual secondments between the German and Chinese offices at the partner and the associate levels. Evidently, next to the relevant skills and experiences such personal ties promote the success of our client's Sino-German projects. We advised Chinese clients on private M&A projects, public M&A projects, purchase of assets of insolvent companies, project financing, D-share listing of Chinese companies on Frankfurt Stock Exchange and many other projects.

## We say...

Successfully implementing Chinese investments in Germany requires a deep knowledge of the local market, which KWM's German team has gathered in all relevant areas over many years. At the same time, it is of utmost importance that the lawyers fully understand the Chinese client's needs as well as the legal and regulatory environment in which the client is contemplating the transaction. The Chinese lawyers at KWM's various locations in China are perfectly placed to understand and guide Chinese clients through the Chinese aspects of any outbound foreign investment. KWM's combined team has over the last five years assisted countless Chinese investors in establishing, acquiring or restructuring its German businesses, whether greenfield, joint ventures, private investments or public M&A or any other contractual arrangements. Together, the team of KWM lawyers from China and Germany (as well as other jurisdictions where needed) provide our clients with the seamless services required to facilitate and implement a successful transaction as well as all other items in the context of doing business in Germany.

**DR. CHRISTIAN CORNETT**



The Chinese lawyers and the German lawyers perceive the King & Wood Mallesons team as one joint team on all Sino-German transactions/projects. This seamless co-operation and experience from a large number of transactions results in a mutual understanding for the specific needs of the Chinese and German side of any such project. German experts deal with German issues, Chinese experts with Chinese issues, legal and non-legal – and together we provide the best solution for our clients.

### We say...

The members of KWM German team have been at the side of Chinese clients since the beginning of the 2000s for their investment projects in Germany. We have been dealing with many milestone projects in the investment history in Germany, for example the first Chinese investment in the automotive industry in Germany, the first D-share listing of a Chinese listed company in Germany, the financing of the biggest Chinese investment in the automation industry and many more. The specific experience we gained through the years adds significant value for our clients and our Chinese clients see us as a secret ingredient for the success of their transactions in Germany.

**HUI ZHAO**

The German and Chinese teams have by now co-operated closely on approx. 100 transactions. Some highlights include

In close co-operation with our Beijing team, establishing CEINEX, the China Europe International Exchange AG, a joint venture between the Frankfurt Stock Exchange (FSE), the Shanghai Stock Exchange and CFFEX.

In a number of transactions, handled in close co-operation with our Beijing team, establishing WEICHAI's position as controlling shareholder in listed German KION Group, a global leader in industrial trucks, related services and supply chain solutions.

Together with the Qingdao, Beijing and Shanghai team, our team assisted Qingdao Haier, which has its primary listing on the Shanghai Stock Exchange, in the successful filing for a listing on the CEINEX D-Share Market, namely the Prime Standard, which forms part of the EU-regulated market of the Frankfurt Stock Exchange (FSE).

In close co-operation with the Beijing and Hong Kong office, preparing the first emission of a renminbi denominated – so-called Panda – Bond for a European sovereign state.

In close co-operation with our Beijing office, acting for Shenzhen listed Masterwork Group in its acquisition of a stake in German listed Heidelberger Druckmaschinen AG by way of cash subscription as part of a strategic co-operation by which Masterwork became the largest shareholder of the German world-leading manufacturer of offset printing equipment and traditional precision mechanical engineering company.

In close co-operation with inter alia the Beijing team, supporting Chinese listed Kingenta Ecological Engineering Group Co. Ltd in the acquisition of COMPO CONSUMER, one of Europe's market leaders in consumer gardening products from a leading European private equity house.

# Meet the team

Your team to unlock Germany opportunities



**Dr. Christian Cornett**



**Rudolf Haas**



**Rüdiger Knopf**



**Dr. Michael Roos**



**Daniel Ehret**



**Markus Herz**



**Markus Hill**



**Dr. Sandra Link**



**Hui Zhao**



**Dr. Tilmann Becker**



**Christian Ostermüller**



**Dr. Johannes Reitzel**



**Hilke Schmitt**

The senior team is completed by junior associates and professional support lawyers, all of which speak German, English and/or Chinese.

# Your points of contact

## Corporate, M&A / Public M&A

**Dr. Christian Cornett**

Frankfurt

T +49 (0)69 50 50 29 309

[christian.cornett@kwm-europe.com](mailto:christian.cornett@kwm-europe.com)

## Corporate, M&A

**Hui Zhao**

Frankfurt

T +49 (0)69 50 50 29 316

[hui.zhao@kwm-europe.com](mailto:hui.zhao@kwm-europe.com)

## Finance / Capital Markets

**Rudolf Haas**

Frankfurt

T +49 (0)69 50 50 29 318

[rudolf.haas@kwm-europe.com](mailto:rudolf.haas@kwm-europe.com)

## Tax / Structuring

**Rüdiger Knopf**

Frankfurt

T +49 (0)69 50 50 29 302

[ruediger.knopf@kwm-europe.com](mailto:ruediger.knopf@kwm-europe.com)





# About King & Wood Mallesons

金杜律师事务所  
KING & WOOD  
MALLESONS

King & Wood Mallesons is an international law firm headquartered in Asia. As a firm in the world able to practice PRC (China Mainland), Hong Kong SAR, Australian, English, the US and a significant range of European laws, our presence and resources in the world's most dynamic economies are profound.

We open doors to global clients and unlock opportunities for them as they look to unleash the fullest potential of the Asian Century. Leveraging our exceptional legal expertise and depth of knowledge in the China market, we advise Chinese and overseas clients on a full range of domestic and cross-border

transactions, providing comprehensive legal services.

Around the world, the firm has over 2,400 lawyers with an extensive global network of 27 international offices. With a large legal talent pool equipped with local in-depth and legal practice, we provide legal services in multiple languages.

Equipped with local in-depth, strong practice capabilities and extensive experience and combined with global vision and resources, KWM provides full-service, multi-jurisdiction, comprehensive, one-stop legal service and the best commercial solutions to meet the diverse needs of domestic and global clients.

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## Europe

### Brussels

Square de Meeûs 1  
1000 Brussels, Belgium  
T +32 (0)2 511 5340

### Frankfurt

KWM Europe  
Rechtsanwalts-gesellschaft mbH  
Taunusanlage 17  
60325 Frankfurt am Main, Germany  
T +49 69 505029 300

### London

11th Floor, 20 Fenchurch Street  
London EC3M 3BY  
UK  
T +44 20 7550 1500

### Madrid

Calle Goya, 6  
28001 Madrid, Spain  
T +34 91 426 0050

### Milan

Milano Largo Augusto 8  
20122 Milano, Italy  
T +39 02 30 31 751

## Middle East

### Dubai

Office 401-404, Gate Village 6, Dubai  
International Financial Centre (DIFC)  
PO Box 24482  
Dubai, United Arab Emirates  
T +9714 313 1700

## Asia

### Beijing

18/F, East Tower, World Financial  
Center, 1 Dongsanhuan Zhonglu  
Chaoyang District Beijing, 100020, PRC  
T +86 10 5878 5588  
F +86 10 5878 5566

### Chengdu

Suite 1603-6, Tower 1, Chengdu IFS,  
No.1 Section 3 Hong Xing Lu, Chengdu,  
Sichuan 610021, PRC  
T +86 28 8620 3818

### Guangzhou

25th Floor, Guangzhou CTF Finance  
Centre  
No.6 Zhujiang East Road, Zhujiang  
New Town  
Guangzhou, Guangdong 510623  
PRC  
T +86 20 3819 1000

### Hangzhou

D Region, 12F Euro America Center,  
No.18 Jiaogong Road, Hangzhou  
Zhejiang, 310012, PRC  
T +86 571 5671 8000

### Hong Kong SAR

13/F Gloucester Tower  
The Landmark  
15 Queen's Road Central  
Hong Kong  
T +852 3443 1000

### Jinan

18/F, Enterprise Square (Shangri-  
La Office Building) No.102, Luoyuan  
Street, Jinan, Shandong 250000, PRC  
T +86 531-55831600

### Nanjing

46/F, Sunny World, 188 Lushan Road,  
Jianye District, Nanjing, Jiangsu,  
210019, PRC  
T +86 025 5872 0800

## Qingdao

10/F, Hisense Building,  
17 Donghaixi Rd., Qingdao,  
Shandong, 266071, PRC  
T +86 532 8579 0008

## Sanya

7/F, Office Building, Plaza of CRREC,  
165 Yingbin Road, Hedong District,  
Sanya, Hainan, 572000, PRC  
T +86 898 8820 9061

## Shanghai

17th Floor, One ICC, Shanghai ICC,  
999 Middle Huai Hai Road, Xuhui  
District, Shanghai 200031, PRC  
T +86 21 2412 6000

## Shenzhen

28th Floor, China Resources Tower  
2666 Keyuan South Road Nanshan  
District Shenzhen, Guangdong 518052  
P.R. China  
T +86 755 2216 3333

## Singapore

10 Collyer Quay  
#37-06/10 Ocean Financial Centre  
Singapore 049315  
T +65 6653 6500

## Suzhou

02A, 43rd Floor, West Tower, China  
Overseas Fortune Center, 9 Suzhou  
Avenue West, Suzhou Industrial Park,  
Suzhou, Jiangsu 215021, PRC  
T +86 512 6292 7100

## Tokyo

Marunouchi Nijubashi Building. 3-2-3  
Marunouchi, Chiyoda-ku, Tokyo 100-  
0005, JAPAN  
T +81-3-5218-6711

## Australia

### Brisbane

Level 33, Waterfront Place  
1 Eagle Street  
QLD 4000, Australia  
T +61 7 3244 8000

### Canberra

Tower B  
7 London Circuit  
ACT 2601, Australia  
T +61 2 6217 6000

### Melbourne

Level 50, Bourke Place  
600 Bourke Street  
VIC 3000, Australia  
T +61 3 9643 4000

### Perth

Level 30  
QV.1 Building  
250 St Georges Terrace  
Perth WA 6000, Australia  
T +61 8 9269 7000

### Sydney

Level 61, Governor Phillip Tower  
1 Farrer Place  
Sydney NSW 2000, Australia  
T +61 2 9296 2000

## North America

### New York

50th Floor  
500 Fifth Avenue  
New York NY 10110  
United States of America  
T +1 212 319 4755

### Silicon Valley

535 Middlefield Road, Suite 245  
Menlo Park  
CA 94025  
United States of America  
T +1 650 858 1285

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