Investment in the New German Federal States

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Investment in the New German Federal States

Fritz K. Koehler*

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This article describes the legal, economic and social situation in the new German federal states as of December 1991, unless otherwise indicated. The present eastern territory of united Germany will be referred to in this article, unless otherwise specified, either as the new federal states ("neue Bundesländer") or as Eastern Germany, and the western territory will be referred to either as the original federal states ("alte Bundesländer") or as Western Germany.

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I. Introduction

Germany historically has been and remains one of the most important economic, political and cultural centers in Europe. A united Germany now shares a common border with nine neighbors, more than any other country in Europe. Given the transformation occurring throughout Eastern Europe and the recent unification of the two Germanies through the Unification Treaty, effective as of October 3, 1990, those businesses with a presence in Germany are poised over the long term to substantially benefit from these continuously expanding markets. These businesses now enjoy both privileged access to the large European Community market and easier access to a potentially dynamic Eastern European market.

1 Vertrag zwischen der Bundesrepublik Deutschland und der Deutschen Demokratischen Republik über die Herstellung der Einheit Deutschlands, August 31, 1990, German Democratic Republic-Federal Republic of Germany, Bundsgesetzblatt, Teil II [BGBl. II], at 877 (Aug. 31, 1991) [hereinafter Unification Treaty]. Since its adoption in 1949, the West German Constitution (or Basic Law) contained two alternatives for accomplishing reunification with East Germany. The first allowed former German territories to accede to the Federal Republic of Germany. This alternative required a declaration of intent to accede by the East German government or its citizenry and West Germany's acceptance of this accession. Following this process East Germany would cease to exist as a separate state subject to the Federal Republic's existing constitution and laws. Grundgesetz [GG] [hereinafter Basic Law], art. 23. The second alternative would terminate the existing constitution on the day a new constitution was adopted by the free choice of the German people. Id. art. 146. In the end, the first alternative was the one actually adopted for reunification. This choice arguably quickened and simplified the overall reunification process. Unification Treaty, supra, chap. III, arts. 8, 9. As a result of reunification, article 23 of the Basic Law became obsolete and was repealed. To reflect the adoption of the first alternative, article 146 of the Basic Law was amended to state that reunification had been accomplished and that united Germany will not make any further territorial claims beyond its present borders. Many other amendments and changes to the Basic Law were necessary to accommodate the accession of East Germany. Certain constitutional deviations have also been granted in the new federal states to ease reincorporation during a transition period up to December 31, 1992. Unification Treaty, supra chap. III, arts. 8-9. For detailed information on these issues, see Jutta Brunnê, The Reunification of Germany: Comments on a Legal Maze, 13 Dalhousie L.J. 725 (1990); Klaus H. Burmeister, German Unification Issues, 12 Whittier L. REV. 229 (1991); Ryszard W. Piotrowicz, The Arithmetic of German Unification: Three Into One Does Go, 40 Int'l & Comp. L.Q. 635 (1991); Peter E. Quint, The Constitutional Law of German Unification, 50 Md. L. REV. 475, 506-16 (1991); Albrecht Randelzhofer, German Unification: Constitutional and International Implications, 13 Mich. J. Int'l L. 122 (1991); Frans G. von der Dunk & Peter H. Kooijmans, The Unification of Germany and International Law, 12 Mich. J. Int'l L. 510 (1991); Note, Taking Reichs Seriously: German Unification and the Law of State Succession, 104 Harv. L. REV. 588 (1990); Gregory S. McCurdy, Note, German Unification: Historical and Legal Roots of Germany's Rapid Progress Toward Unity, 22 N.Y.U. Int'l L. & Pol. 253 (1990); Rudolf Streinz, Die völkerrechtliche Situation der DDR vor und nach der Vereinigung, 6/1990 Europäisches Wirtschafts & Steuerrecht [EWS] 171 (Oct. 15, 1990), (discussing the ramifications for international law of German unification).

2 Businesses with a presence in the new federal states are in a position to potentially exploit the large markets of the European Community (325 million residents), Northern Europe (180 million), and the former East Bloc countries. Treuhandanstalt, The Chance of the 90's: Investing in Eastern Germany 4 (1991) [hereinafter Treuhand, Investing in Eastern Germany].
Unless they have had prior experience with former East Germany, any person or business entity seriously considering investing in one or more of the new German federal states (Brandenburg, Mecklenburg-Vorpommerania, Saxony, Saxony-Anhalt, and Thuringia) should take the trouble to travel there in order to form an impression of the overall environment in which the proposed investment is to take place. The remarkable economic, social and legal developments that have taken place over the last two years in the new federal states offer many intriguing business opportunities for those investors with a long-term investment horizon. These opportunities, however, are not without substantial risk and significant impediments to investment still remain.

Potential investors should weigh the advantages and disadvantages of investing in the new federal states. Although immediate investment in the new federal states certainly entails more financial risk than waiting

3 The formation and territorial borders of the five new federal states are set forth in the “Federal States Establishment Law” (Verfassungsgesetz zur Bildung von Ländern in der Deutschen Demokratischen Republik-Einführungsgesetz, Gesetzblatt der DDR, Teil I GBl.DDR I, at 955 (Aug. 14, 1990)) and the Unification Treaty, supra note 1, ch. I, art. 1. For a map of unified Germany, see Appendix A. East Berlin was incorporated into West Berlin, an original federal state, and together they now form the federal city state of Berlin. For the purpose of this article, the new federal states include the eastern part of Berlin unless otherwise specified. The newly united city of Berlin is the new capital of united Germany.

4 A series of interrelated events are widely held to have brought about the unification of the two Germanies. With the easing of border restrictions in Hungary, beginning in May 1989, came the first sizable migration of East German residents into West Germany since the erection of the Berlin Wall in 1961. The ensuing migration of East German residents into West Germany escalated steadily during the summer of 1989, and it is estimated that approximately 344,000 East Germans migrated to West Germany in 1989. See ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD), OECD ECONOMIC SURVEYS: GERMANY 48 (1990); Quint, supra note 1, at 483-87. This mass migration and the general discontent of the East German populace with their socialist government and planned market economy directly influenced the opening of the East German borders, the fall of the Berlin Wall on November 9, 1989, and eventually German unification on October 3, 1990. On September 12, 1990, the Allied Powers (the United States, the Soviet Union, United Kingdom, and France) signed the “Treaty on the Final Settlement with Respect to Germany” paving the way for German reunification. Vertrag über die Abschliessende Regelung in Bezug auf Deutschland, BGBI. II at 1317 (1990), reprinted in 29 I.L.M. 1186 (1990). A large number of Soviet troops (approximately 350,000) are to be phased out in the new federal states by 1994. TREPUEBAD, INVESTING IN EASTERN GERMANY, supra note 2, at 6; A Survey of Germany, ECONOMIST, May 23, 1992, at 58.

These rapid political and societal changes in East Germany were mirrored by a number of sweeping changes in the economy and the law. Prior to 1990, the commercial setting in East Germany had been dogged by an increasingly doctrinaire form of planned economy and little incentive existed for domestic entrepreneurship or foreign investment. Central planning and management had become the central pillar of East Germany’s economy, foreign trade and foreign payments were overseen by a state monopoly, private ownership of the means of production was prohibited in all essential economic sectors, and the legal framework of East Germany’s planned economy had become administrative rather than commercial in nature. As the rapid political and societal changes unfolded in 1989 and 1990, it became increasingly clear that a economic and legal transformation would also have to occur in East Germany.
for economic conditions to stabilize, this consideration must be weighed against the possibility of lost opportunities, increased barriers to market entry, and saturated markets. For businesses who have already established subsidiaries or branch offices in West Germany, expansion into the new federal states is a logical step. Businesses without a presence in Germany, however, should also consider investment in alternative sites in Western or Eastern Europe and/or initially establishing or expanding exports to the new federal states in lieu of direct investment.

This article is intended to furnish the reader with qualitative insights and practical legal advice concerning the current investment climate and opportunities in the new German federal states, as well as highlighting the potential pitfalls and risks to be avoided. It provides a general overview of: (i) the current economic, social and legal environment in the new federal states; (ii) the Treuhand, which is the governmental organization in charge of privatizing formerly state-owned businesses, and the issues to be particularly aware of when acquiring a business and/or real property in the new federal states; (iii) the various investment incentives and subsidies available on a federal, state or European Community level for investors in the new federal states; and (iv) the incorporation and current status of the new federal states within the European Community.

This article is meant to offer general information to potential investors considering investing in the new federal states. The range in diversity among regions, government bureaucracies, and local business conditions in the new federal states has made generalization particularly difficult. Due to the fact that the business and legal practices, as well as the laws and regulations in the new federal states continue to change rapidly, it is strongly emphasized that this article cannot and should not serve as a substitute for specific legal, tax, business or accounting advice concerning a contemplated investment.

II. CURRENT ECONOMIC AND LEGAL ENVIRONMENT

A. Economic Environment.5

1. General

In sharp contrast to its other Eastern European neighboring countries, Eastern Germany's transformation from socialism to democratic capitalism has been somewhat cushioned by the economic, social and

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legal infrastructure of its Western German counterpart. Furthermore, Eastern Germany continues to possess the most skilled labor force and advanced economy in Eastern Europe, and investors in the new federal states need no longer be concerned about the availability of foreign exchange, protection from expropriation, the ability to repatriate profits, and the free alienability of property. There are currently no significant restrictions on foreign investment in Germany, including the new federal states, and a foreign-owned business may be established anywhere in Germany, subject only to the same restrictions that would apply to locally-owned businesses.

Nevertheless, in sharp contrast to West Germany, economic development in former East Germany had, until recently, progressed at a snail's pace. Still plagued with an inefficient command economy and an obsolete industrial base, the new federal states remain in the midst of an economic recession. One need only travel to any one of the five new federal states to realize how little economic progress has taken place since the outbreak of the Second World War. As an example, after nearly fifty years of neglect, most of the commercial and residential buildings located in Eastern German cities are in extremely poor condition and in many cases in need of gutting and complete renovation. On the positive side, however, there is a flurry of building and construction activity currently taking place throughout the five new federal states. In addition, the great majority of the countryside has remained in the

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7 See Commission of the European Communities, The European Community and Unification, Bulletin of the European Community, Supp. 4190, at 30 (1990) [hereinafter EC Unification Bulletin]. Per capita income in East Germany as of 1990 was higher than in Ireland, Greece or Portugal, but less than in Spain. Id.

8 Although free alienability of property is now the legal norm, given the amount of reprivatization taking place in the new federal states and the number of outstanding restitutionary claims which remain unsettled, property ownership issues continue to cause problems for interested investors. See infra section III(C)(1).

9 Basic Law, arts. 2(1), 12(1), 14. See also H. Jarass & B. Pieroth, Kommentar: Grundgesetz für die Bundesrepublik Deutschland (1989). Specific licenses are necessary only in certain businesses, such as banking, insurance, transportation, retail trade in food, medical and pharmaceutical products, and hazardous business activities. Business International Corporation, Investing, Licensing & Trading Conditions Abroad: Germany 5-6 (Sept. 1991) [hereinafter IL&T].

10 See infra section I(a)(3).

11 See Treuhand, Buying Companies, supra note 6, at 17.

same pristine condition it was in prior to the 1940's (environmental contamination aside), whereas the countryside in the original federal states has been largely developed.

It will take some years before the new federal states can reach economic parity with their Western German counterparts. Assuming growth rates at the same levels experienced by West Germany directly following the Second World War, it is projected that the new federal states will require a number of years to come up to speed. If the actual growth rates turn out to be lower, economic parity could take much longer.

A number of intriguing opportunities to invest in existing businesses are available, however. The most promising opportunities are said to be in machine tools, printing equipment, porcelain, precision instruments and optics, shipbuilding, and heavy equipment, although the firms in these industrial sectors remain primarily in need of management skills, product design, know-how, and marketing. In addition, numerous new business opportunities exist in markets which either had not previously existed or have yet to be fully exploited.

2. Political and Social Setting

The dismantling of the former socialist political, administrative, economic and social apparatus has had a noticeable effect on the morale and short-term economic prosperity of the population in the new federal states. Following the euphoria which prevailed during the ousting of the socialist cadre and up through reunification, the population now has begun to experience the hardships and sacrifices that it will have to endure in order to complete the transformation from a socialist to a social market-oriented economy ("Soziale Marktwirtschaft"). Many Eastern

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13 For an overview of the extent of environmental contamination in the new federal states, see infra section III(C)(4).

14 The Treuhand estimates that in order to reach a productivity level equal to that of the West German federal states by the year 2000, the new federal states will require an average annual growth of 10% and inbound investment of DM 136 billion. Privatisierung hilft am besten, SÜDDEUTSCHE ZEITUNG, Oct. 26, 1991, at 34, col. 1. See also Vorsprung durch Panik, ECONOMIST, Feb. 15, 1992, at 53-54 (Western German industry is planning to invest DM 36 billion in Eastern Germany in 1992 alone).

15 See AMERICAN CHAMBER OF COMMERCE IN GERMANY, INVESTMENT IN EAST GERMANY: OPPORTUNITIES AND OBSTACLES 11 (July 1991) [hereinafter ACC, OPPORTUNITIES AND OBSTACLES].

16 These are said to include among others: (i) consumer products; (ii) environmental protection and energy-related equipment and technology; (iii) medical systems; (iv) real estate development; (v) data processing; (vi) hotels and restaurants; (vii) travel and tourism; (viii) professional services (legal, consulting, financial, and accounting); (ix) infrastructure development (telecommunications, transportation, mail services, and sanitation); (x) housing and office space; and (xi) construction and renovation. Id. at 13-14.
Germans have either forgotten or not yet realized that it is not the introduction of a free market economy but rather the legacy of mismanagement and a socialist planned economy that is responsible for their current economic plight. Nevertheless, unlike many of the other former Eastern Bloc countries, Eastern Germany should undergo a relatively non-turbulent economic and social transformation. The new federal states have become part of a modern and stable political system, and there are no significant disagreements with regard to the basic political, economic or social goals sought by the majority of the population.17

3. Short-term Economic Outlook

It is projected that the new federal states will experience a recession until the end of 1992 and then benefit thereafter from a rapid economic upturn.18 Many businesses in the new federal states are facing both declining domestic demand for their products due to the availability of superior Western products and declining demand in traditional export markets in the Eastern European countries due to the chronic economic problems and payment difficulties which currently exist in those countries.19 Furthermore, demand and production in the new federal states has primarily been stimulated up to this point by transfer payments from Western Germany.20 Nevertheless, an upturn in 1993 is expected as the economy in the new federal states begins to benefit from intensive capital investment, increased competitiveness, and the maturing of a booming service industry.21 The insatiable demand of the sixteen million inhabit-

17 Even so, radical right political movements (e.g., so-called "neo-Nazis") have gained a small following in East Germany of mostly unemployed youth and senior citizens by playing on their fears of mass migration from the East and the changing demography of Germany. One focal point of this xenophobia has been asylum-seekers in Germany. Due to Germany's liberal asylum laws, primarily a result of a reaction to its Nazi past, almost half of all applicants for political asylum in Europe have been admitted into Germany (roughly 193,000 in 1990), which is an extremely high number given Germany's indigenous culture. During the past year, many asylum-seekers have become the victims of violent attacks by neo-Nazi mobs. These violent attacks resulted, however, in outrage and an outpouring of sentiment for the asylum-seekers by the overwhelming majority of the German population. Although the basic asylum laws in Germany have not been revamped, as has been called for by legal and social commentators from almost all political parties and social groups, the German government has undertaken a number of measures in order to try to reduce the attacks, screen asylum-seekers more closely, and expedite the asylum process. John Marks, New Germany's Old Fears, U.S. NEWS & WORLD REPORT, Oct. 14, 1991, at 20; Rechtsextremisten werden besser beobachtet, SÜDDEUTSCHE ZEITUNG, Dec. 15, 1991, at 5, col. 1; Gesetz über das Asylverfahren [AsylVfG], BGBl. I, at 869 (Apr. 9, 1991); A Survey of Germany, supra note 4, at 58.


19 EC UNIFICATION BULLETIN, supra note 7, at 52.

20 Finanz- und tarifpolitisches Augenmass nötig, supra note 12, at 1.

21 See IL&T, supra note 9, at 3.
nants in the new federal states for Western consumer goods should also help fuel economic recovery once Eastern German goods as a whole become more competitive.

4. Local Management

The quality of local management in the new federal states is highly questionable, and it will take some time before Eastern German management can match its Western German counterpart. Very few Eastern German managers have had real market experience, and it is estimated that two-thirds of all Eastern German managers will require substantial retraining. The Treuhand, the governmental organization primarily responsible for privatizing the former East German economy, estimates that there is a need for 9,000 to 10,000 qualified managers in the new federal states, particularly in the areas of sales, marketing, personnel management, finance, and cost accounting. Due to the lack of qualified management in the new federal states, the Treuhand and many investors have found it necessary to bring in Western managers, even if for a transitional period. Even with the lure of salaries often up to 40% higher than they would receive in the West and with the chance to receive management responsibility most of them could only dream of receiving in the West, Western managers, even those from Western Germany, have been reluctant to work for extended periods in the new federal states given the relatively low standard of living there.

The quality of life in the new federal states is likely to improve rapidly, but this transition will nevertheless take quite some time. Alarming, however, are reports that approximately 75% of those Western managers already working or willing to work in the new federal states are "rejects" who no longer perceive a future for themselves as managers in the West, and that the remainder are qualified but were either previously unemployed or have special "ulterior" motives for wanting a change. Up to October 1991, 500 Western managers have become managing directors or board members in the

22 Dietrich Hochstätter, 5 zu I gegen den Wessi, 43/1991 WW 42 & 47 (Oct. 18, 1991). As of September 1991, the Treuhand had dismissed over 1,500 Eastern Germans holding senior management positions at transformed companies for primarily the following reasons: (i) 500 due to managerial incompetence; (ii) 400 due to the previous practice of over staffing; (iii) 100 due to bribery, embezzlement or other criminal activities; and (iv) 400 due to their political sentiments for or ties with the former socialist regime and/or secret police. Id. The Treuhand estimates that an additional 500 to 1,000 will be dismissed once it has a chance to systematically examine each managers personal background and qualifications. Id.

23 See infra section III(B).

24 Hochstätter, supra note 22, at 50.

25 For an interview on this topic with Alexander Koch, the Treuhand's head of personnel, see Bolke Behrens, Entsetzliches Defizit, 43/1991 WW56 (Oct. 18, 1991).

26 Hochstätter, supra note 22, at 53.

27 Id.
Eastern German private sector, and an additional 1,500 joined the senior management of companies held in trust by the Treuhand on either a short-term or permanent basis.28

5. Business Ties with Eastern Europe

Although many Eastern Germans, aside from linguistic capabilities in Russian and other Slavic languages, may also have limited business contacts with the republics of the former Soviet Union, Poland, Czechoslovakia, Hungary, and other Eastern European countries, these contacts typically have proven to have limited value.29 Prior to 1990, most trade among Eastern European countries was undertaken by centralized trading firms and most individual companies never actually established business ties or distribution networks with foreign companies.30 If such economic contacts did in fact exist with Eastern European companies, the majority of such contacts have in all likelihood disappeared due to the chaotic socio-economic transformation of the Eastern European countries and the collapse of their respective markets.31 Nevertheless, access to Eastern European markets in the medium or long term may be enhanced by establishing a business presence in the new federal states.

6. Labor and Productivity

Wage levels in the new federal states are rising rapidly toward Western German levels even though the productivity of Eastern German workers was merely 30% of their Western German counterparts as of August 1991,32 and it is yet to be seen what the effect of looming mass unemployment in the new federal states will have on productivity and relative wage levels. The increase in wage levels can be largely attributed to wage and collective bargaining agreements concluded in the Autumn of 1990 and the Spring of 1991 which brought wage levels for Eastern German workers up to 60% of Western German workers, and wage levels in Eastern and Western Germany are scheduled to reach parity by 1994.33 Nevertheless, although basic hourly wages will reach parity by 1994, real earning levels will remain approximately 30% below Western

28 Id. at 56.
29 See ACC, OPPORTUNITIES AND OBSTACLES, supra note 15, at 7.
30 Id. See also EC UNIFICATION BULLETIN, supra note 7, at 51.
31 See EC UNIFICATION BULLETIN, supra note 7, at 52; Ginsburg, supra note 6, at 44-50.
32 IL&T, supra note 9, at 22.
33 Id. See also TREUHAND, BUYING COMPANIES, supra note 6, at 18. These wage increases have been criticized by many commentators and politicians, because they effectively made employee reductions necessary in the face of greatly increased labor costs in order for many of the companies in the new federal states to remain or become competitive. See id.; BUNDESVERBAND DER DEUTSCHEN INDUSTRIE (BDI), MITTELSTAND IM AUFBAU 2 (summary of a conference on entrepreneurship held in Leipzig on April 25, 1991) [hereinafter BDI, ENTREPRENEURSHIP]. The average
Germany levels, because the work force in the new federal states will not enjoy the same fringe benefits, short work hours, or long vacations as their Western German counterparts.\textsuperscript{34}

Productivity levels are now actually declining further as a result of the economic shakeup, and it is estimated that the current unemployment rate of approximately 12%\textsuperscript{35} in the new federal states could balloon to more than 25% as a result of the ongoing liquidation of unprofitable businesses and the elimination of excess labor in viable businesses.\textsuperscript{36} The federal and state governments have undertaken a number of measures and training programs to temper this increasing unemployment.\textsuperscript{37} In addition, enormous subsidies, including billions of Deutsche Marks for un-

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Western German worker’s hourly wage is $13. Including non-wage costs, that average hourly wage rises to $24. Chasing Cheap Labour, ECONOMIST, Jan. 25, 1992, at 66.

Minimum wage levels are not fixed by law, but collective bargaining and other agreements between trade unions and employer associations or individual employers often establish wage levels, fringe benefits, and working conditions, which are legally binding.\textsuperscript{34}

\textsuperscript{34} TREUHAND, BUYING COMPANIES, supra note 6, at 18. For example, every Western German worker is entitled to at least twenty days of paid vacation per year while every Eastern German worker is entitled to only fifteen days. Bundesurlaubsgesetz [BUrlG], § 3, as amended by Unification Treaty, supra note 1, appen. I, chap. VIII(A), § 3(5). This amount of paid vacation is a legal minimum, and most Western German employees receive an average of 5.5 weeks, often as a result of collective bargaining agreements. See IL&T, supra note 9, at 23.

\textsuperscript{35} Leichter Anstieg der Arbeitslosigkeit im Osten, FRANKFURTER ALLGEMEINE ZEITUNG, Nov. 7, 1991, at 15, col. 3; Mehr Erwerbslose im Osten, SÜDDEUTSCHE ZEITUNG, Nov. 7, 1991, at 1, col. 3.


\textsuperscript{37} Part-time workers, those undergoing full-time technical training, and those in government-sponsored provisional work programs in the new federal states pursuant to the Employment Promotion Act (“Arbeitförderungsgesetz”) were estimated at 1.94 million (or roughly 28% of the labor force) in October 1991. Leichter Anstieg der Arbeitslosigkeit im Osten, supra note 35, at 15; Mehr Erwerbslose im Osten, supra note 35, at 1. For a brief description of the currently available employment assistance programs, see BMWi, ASSISTANCE PROGRAMS, infra note 384, at 114-121; ACC, INVESTMENT INCENTIVE PROGRAMS, infra note 384, at 25-26. As of July 1991, the Treuhand established “employment companies” in each of the five new federal states to employ and train limited amounts of Eastern German workers in order to bring them up to Western German standards and productivity levels. The Treuhand is responsible for staffing all such companies and for providing 10% of their capitalization, with the remaining 90% coming from the unions, the employers’ associations, local associations, and the respective federal state. See Richtlinien zur Umsetzung der Rahmenvereinbarung zur Bildung von Gesellschaften zur Arbeitsförderung, Beschäftigung und Strukturentwicklung (ABS) (July 17, 1991), reproduced in 6/1991 TREUHANDINFO 11; Oliver Passavant & Gerhard Nösner, The German Reunification—Legal Implications for Investment in East Germany, 23 INT’L LAW. 875, 876 n.2 (1991). As of February 1992, these employment companies, numbering almost 250, provided work for roughly 200,000 former employees of companies held by the Treuhand. See DEUTSCHE BANK RESEARCH 12-13 (April 1992) [hereinafter DBR]. For a detailed discussion of the employment companies, see Hanau, Sozialverträgliche Gestaltung bei der Umstrukturierung und Auflösung von Unternehmen, TREUHANDUNTERNEHMEN IM ÜMBRUCH (RWS-FORUM 7) 101, 115-19 (Hommelhoff ed., 1991).
employment compensation, have helped somewhat to ease the impact of widespread unemployment.\textsuperscript{38}

In sharp contrast, the Western German federal states are currently experiencing an actual increase in demand for labor, and since mid-1990 an estimated 500,000 Eastern Germans are estimated to have relocated and found employment in Western Germany.\textsuperscript{39} An additional 270,000 Eastern Germans have found work in Western Germany and commute each day from one of the new federal states.\textsuperscript{40} If this increasing demand for labor in the western part of Germany continues, it should help to further alleviate some of the pressure on the Eastern German labor market, although the new federal states may lose some of their most skilled work force as a result.

7. Tax Rates

Both domestic and foreign businesses doing business in Germany are subject to relatively high tax rates.\textsuperscript{41} Resident corporations are taxed at a rate of 50\% on retained earnings and at a rate of 36\% on distributed earnings, while nonresident corporations are subject to a rate of 46\% on both retained and distributed earnings.\textsuperscript{42} Although the federal govern-

\textsuperscript{38} The German government is currently injecting approximately DM 150 billion into Eastern Germany for income support measures, corporate subsidies, and infrastructure development. \textsc{Treuhand, Investing in Eastern Germany, supra note 2, at 4. In 1990, the German government gave out an estimated DM 75 billion for part-time work programs, unemployment benefits, and supplemental pension benefits. Id. at 7.}

\textsuperscript{39} \textsc{Il\&T, supra note 9, at 20.}

\textsuperscript{40} \textsc{DBR, supra note 37, at 13. Arbeitslosigkeit, Handelsblatt, Oct. 9, 1991, at 1, col. 2; Zahl der Arbeitslosen auch im Osten gesunken, Süddeutsche Zeitung, Oct. 9, 1991, at 1, col. 3.}

\textsuperscript{41} A business entity's tax status primarily depends on its business form. Corporations are treated as taxable entities and are subject to corporate tax. Partnerships, on the other hand, are not treated as taxable entities for income tax purposes but rather as pass-through entities. Each partner must report his proportional pass-through share of partnership profit in his personal tax return. Einkommensteuergesetz [EStG], § 15(1). The interest of a non-German corporation in a German partnership constitutes a permanent establishment of such corporation in Germany, and all income from such interest is subject to a corporate tax rate of 46\%. Körperschaftsteuergesetz [KStG], §§ 2(1), 23(2)-(4).

Corporate entities resident in Germany are subject to German corporate taxation on their worldwide income and capital gains. A business entity is considered to be resident in Germany if it has its seat or headquarters in Germany. \textit{Id.} § 1(1). Non-resident corporations are only liable for income and capital gains sourced in Germany, which include: (i) income received through a permanent establishment or permanent representative in Germany; (ii) gains from the sale of shares in a German corporation in which the seller holds more than a 25\% interest; (iii) income from agriculture and forestry; (iv) rental income; and (v) specific categories of income where income is withheld at the source. \textit{Id.} § 49(1).

\textsuperscript{42} KStG § 23(1). A German corporation must withhold 36\% of profit distributed by means of dividend distributions for purposes of corporate tax and 25\% of the dividend after deduction of corporate tax for purposes of withholding tax. \textit{Id.} §§ 43a(1), 50a(4). German resident shareholders must gross up the dividends received by the amount of withholding tax and corporate tax withheld.
ment had originally planned to lower these rates in early 1991, the exorbitant costs associated, among other things, with reunification, the Persian Gulf war, and increased aid to the former Eastern Bloc countries, made a tax reduction fiscally impracticable. In addition, a one-year surcharge on individual income and corporate taxes of 7.5% (the so-called "Solidarity Tax") was instituted in mid-1991 to help compensate for high expenditures with respect to the new federal states.43

Nevertheless, the German federal government, the federal state governments, and the European Community offer both foreign and domestic investors numerous tax and other incentives and subsidies which may help to reduce effective tax rates and bolster real rates of return.44 In addition, qualifying businesses in the new federal states are exempted up to the end of 1994 from liability for two forms of capital asset tax.45

at the corporate level. Nevertheless, shareholders are entitled to a credit against their personal or corporate income tax liability for the amount of both the withholding tax and the underlying corporate tax retained at the corporate level. EStG §§ 27, 36(2). Non-resident dividend recipients, however, are generally not entitled to the benefits of such imputation system. Id. §§ 1(4), 50(5).

The Tax Reform Act of 1990 reduced the top income tax rate for individuals from 56% to 53%, the tax rate on retained earnings of resident corporations from 56% to 50%, and the applicable tax rate for non-resident corporations from 50% to 46%. Steuerreformgesetz 1990, BGBl. I, at 1093, arts. 1, 2 (Aug. 2, 1988). See also H. Scheidel, Steuerreform 1990 (1988).


44 For a summary see infra section III. There has been some criticism that standard Western German incentive programs are not well suited for the new federal states and that a new assistance program should be developed. The main problem is the lack of an elastic multiplier effect and the inability of businesses to utilize tax incentives, such as special depreciation, when they do not have gross business income. BDI, ENTREPRENEURSHIP, supra note 33, at 1.


All German business entities are fundamentally subject to municipal trade taxes on income and capital ("Gewerbesteuer"). The trade tax is based on a federal statute, but is levied by the municipalities. Trade tax on income determined by reference to tax adjusted financial statements is levied at rates between 15% and 20%. GewStG, § 11(2). Trade capital is the assessed value as determined for net worth purposes after certain additions and deductions. The effective trade tax rate on capital is
Furthermore, personal tax exemptions were raised so as to effectively exempt many residents in the new federal states from having to pay income taxes.\textsuperscript{46}

In conjunction with efforts of the European Community to create a common market and to bring the various tax laws of the EC member states into conformity, major tax reform has been promised by the German government by 1993. The overall costs of unification and other recent events, however, may lead to a postponement of such a reform.\textsuperscript{47}

8. Infrastructure

The new federal states possess a poor infrastructure (including telecommunications, transportation and sanitation systems), but since they are practically starting from scratch and a sizable amount of funds has already been allocated by the German federal government for erecting a suitable infrastructure,\textsuperscript{48} the new federal states should eventually have one of the most advanced transportation and telecommunication systems in the world. The telecommunications infrastructure has already improved quite considerably and should soon reach or surpass Western standards.\textsuperscript{49}

9. Marketing and Distribution Channels

The new federal states still lack the sophisticated marketing and distribution channels to which most Western companies are accustomed, and it will take some time before such systems can be fully implemented.\textsuperscript{50}

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\textsuperscript{46} ld. § 13(2). Trade tax is deductible in determining trade income. Payments of trade tax on capital and on income are combined. In addition to exemption from trade capital taxation, small and medium-sized firms located in the new federal states have indefinitely been granted a graduated reduction in the normally applicable trade income tax rates. Id. § 11(1).

The net worth tax ("Vermögensteuer") is a tax on the net worth of individuals and corporate entities, and only net property, after the deduction of debts and liabilities, is subject to net worth taxation. Resident taxpayers are subject to net worth tax on their entire worldwide property, unless double tax treaty relief is available. VermStG, § 4(1). Non-resident individuals and business entities are subject to net worth taxation only for property located within Germany. Id. § 4(2). The net worth tax rates are either 0.5\% or 0.6\% respectively. Id. § 10. The tax rate is levied in accordance with assessments which are generally made in three-year increments. Id. § 15(1).

\textsuperscript{47} See EStG §§ 9(a)(1), 32(a)(1). Taxpayers with their sole residence in the new federal states are also granted an annual income tax allowance during 1991 to 1993 in the amount of DM 600/1,200 (single/married). Id. § 32(8), as amended by 1991 Tax Reform Act, art. 1(4).

\textsuperscript{48} To this end, the Transportation Ministry plans to spend DM 15 billion, the Environmental Ministry DM 5 billion, and the Postal Ministry (which also has practically a monopoly over the telecommunications industry) DM 55 billion over the next few years. TREUHAND, BUYING COMPANIES, supra note 6, at 17.

\textsuperscript{49} TREUHAND, INVESTING IN EASTERN GERMANY, supra note 2, at 5.

\textsuperscript{50} See John E. Blyth, Incentives and Impediments to U.S. Investment in the Former German Democratic Republic, 63 N.Y. St. B.J. 8, 14 (1991).
10. Technical and Safety Standards

Most of the technical and safety standards which have long been in place in Western Germany are now in force in the new federal states as well.\(^{51}\) This will eventually result in better and safer products for consumers but also will result in increased red tape and costs for producers.

B. Legal Environment

The "Monetary, Economic and Social Union" [hereinafter MESU] between the two Germanies, which entered into effect on July 1, 1990, was the initial legal step towards reunification.\(^{52}\) The MESU sought to set in motion the transformation of the East German economy into a market economy through East Germany's adoption of certain monetary, economic and social principles. These changes required incorporation of substantial portions of West German law and the repeal of inconsistent East German laws, including constitutional provisions.\(^{53}\) In this way, the MESU helped to ease the final transition which occurred on October 3, 1990 with the signing of the Unification Treaty.\(^{54}\)

As of German reunification, almost the entire body of West German

\(^{51}\) See generally Unification Treaty, supra note 1, app. II.


\(^{53}\) The monetary union called for the adoption of the West German Deutsche Mark as the single currency of the two Germanies, the West German Federal Reserve Bank ("Bundesbank") to be given jurisdiction over East Germany's monetary system, and the adoption by East Germany of a number of West German banking and credit laws. MESU, art. 10. In addition, the Ost-Marks (the then East German currency) in circulation were exchanged into Deutsche Marks as follows: (i) wages, salaries, grants, pensions, rents, leases, and similar periodic forms of recompense were converted at a 1:1 rate; and (ii) other claims and liabilities were generally converted at a 2:1 rate. Id. art. 10(5). The economic union sought to harmonize the economic and financial policies of the two Germanies through the adoption of a number of West German codes and statutes and the repeal of conflicting East German laws. Of particular importance was the repeal of all provisions of East German law that were inconsistent with freedom of contract, freedom of association, and private property rights (art. 2); and the introduction of private property rights (art. 1(3)). Finally, the social union generally called for East Germany's adoption of West Germany's employment law and social security system. In addition, the MESU provided for the adoption by the new federal states as of January 1, 1991, of almost all of West Germany's tax provisions regarding personal and corporate income tax, trade tax, net worth tax, real estate tax, inheritance and gift tax, and property valuation. Id. art. 31. As a result, the East German tax system was almost completely replaced as of January 1, 1991, with the West German tax system. See generally Scheifele & Schweyer, Grundzüge des Wirtschaftsrechts der DDR nach dem Staatsvertrag über die Schaffung einer Währungs-, Wirtschafts- und Sozialunion zwischen der Bundesrepublik und der DDR, 6-7/1990 GMBHR 241 & 285 (June 15 and July 15, 1990) (published in two segments); Scholz, Der Staatsvertrag zur Währungs-, Wirtschafts- und Sozialunion, 7/1990 RIW (DDR RECHTSENTWICKLUNGEN) Folge 9:1 (July 1990).

\(^{54}\) See text accompanying supra note 1.
law became effective in the new federal states.\textsuperscript{55} A few former East German laws, however, remain in effect and will be phased out over time.\textsuperscript{56} In cases where the Unification Treaty and subsequent legislation has not addressed a specific legal area, the principles of conflict of laws and state succession should generally be applicable.\textsuperscript{57} European Community law and international agreements to which West Germany is a party also have become effective in the new federal states, which means, among other things, that the new federal states are now entitled to the benefits of EC and GATT membership.\textsuperscript{58}

While assumption of West Germany's sophisticated and proven body of law has saved the new federal states the tedious and complicated

\textsuperscript{55} Unification Treaty, \textit{supra} note 1, chap. III, art. 8. The Unification Treaty established the basis under international and domestic law for German reunification. The Treaty called for the adoption of the Basic Law on October 3, 1990, by the five new federal states. Numerous amendments and changes to the Basic Law were necessary to accommodate the accession of East Germany, and certain constitutional deviations have been granted to the new federal states to ease reincorporation during a transition period up to December 31, 1992. See generally Streinz, \textit{Die im Internation len Steveriecht: Zur Rechtslage in der ehemaligen DDR ab 1, 6/1990 EWS 171} (Oct. 15, 1990). Following the general format as set forth in the MESU, the Unification Treaty generally stipulated that the entire West German tax system was to become effective in the new federal states as of January 1, 1991. For an in-depth discussion of these tax law changes, see \textit{Gesetzgebung: Steuernderungen im Einigungsvertrag}, 18/1990 DStR 537 (Sept. 21, 1990); Dornberger & Dornberger, \textit{Der Staatsvertrag und die Umgestaltung des DDR-Wirtschaftsrechts}, DB (DDR REPORT) 3007 (June 1, 1990); Winfried Füst & Rolf Kroker, \textit{Steuerreform in der DDR: Erster Schritt zur Angleichung der Steuersysteme}, 3/1990 \textit{STEUER UND WIRTSCHAFT} [STuW] 274 (Aug. 1990); Manfred Wachenhausen, \textit{Zur Übernahme bundesdeutschen Steuerrechts in die DDR}, 3/1990 STuW 268 (Aug. 1990). In the interim period, the tax law of East Germany remained in effect. Certain provisions of the tax law of former East Germany, however, will remain effective after January 1, 1991 in the new federal states. A "Unity Fund" was also provided for in the Unification Treaty to be established by the unified German government to finance the economic transformation of the new federal states. Unification Treaty, \textit{supra} note 1, app. I, chap. IV, § II(1), \textit{amending} Gesetz über die Errichtung eines Fonds "Deutsche Einheit", BGBl. II, at 518 (June 25, 1990). See also ACC, \textit{INVESTMENT INCENTIVE PROGRAMS}, \textit{infra} note 384, at 23. The Unification Treaty also called for the creation of specific subsidies for the promotion of economic development in the new federal states for: (i) regional areas; (ii) municipalities; (iii) small businesses; (iv) reorganization and modernization of the economy; and (v) debt relief for entrepreneurs. Many of these subsidies and investment incentives have been established. For a summary, see \textit{infra} section III.

\textsuperscript{56} Given the economic and social disparities between the two Germanies, a number of exemptions, amendments and phase-in rules were adopted in order to ease integration of the new federal states. Appendix I of the Unification Treaty comprehensively lists such legislation, and if a West German statute is not mentioned, it automatically became effective in its then-existing form as of October 3, 1990. Appendix II lists the former East German laws which were to remain in force in the new federal states.

\textsuperscript{57} \textit{See} Ebke, \textit{Legal Implications of Germany's Reunification}, 24 \textit{INT'L LAW.} 1130 (1990).

process of creating a new legal framework, as is currently being under-
taken by the other Eastern European countries, West German law does
not always correspond with the economic and social realities that cur-
rently exist in the new federal states. The pace and quality of economic
development in the new federal states will certainly depend upon the
ability of German lawmakers to adopt legal norms to continuously
changing economic and social realities.

III. PRIVATIZATION MECHANISM — THE TREUHAND

A. Legal Background

After the overthrow of the old socialist party cadre in East Ger-
many, the next logical step was the dismantling of the socialist planned
economy and the institution of a more flexible and dynamic free market
economy. By the end of 1989, it became all too clear that the property
system in East Germany had to be completely restructured in order to
spur economic growth and to accommodate foreign investment. The
first, albeit feeble, step in this direction was the amendment of article
12(1) of the East German Constitution on January 12, 1990. This
amendment repealed the long-standing prohibition against private own-
ership of the means of production, and adopted a new article 14(a) to the
Constitution allowing for the formation of business entities with foreign
participation by the traditional economic entities, craftsmen, business-
men, and private citizens.59

Approximately two weeks later, an ordinance (the “Joint Venture
Ordinance”) was promulgated to allow for the formation of joint ven-
tures with foreign investors, contingent upon approval by the East Ger-
man government.60 The ordinance did not contain guidelines which the
East German authorities could consider in making their determination,
but rather denied foreign participation where the formation of a joint
venture would run counter to national or regional economic interests or
where there was danger that a foreign investor might exercise dispropor-
tionate influence to the detriment of the East German participant or to

59 Law Gazette of the German Democratic Republic I [GBI.DDR I], at 15 (Jan. 12, 1990). See
also Michael J. Thomerson, Note, German Reunification — The Privatization of Socialist Property on
60 Verordnung über die Gründung und Tätigkeit von Unternehmen mit ausländischer
Beteiligung in der DDR, GBI.DDR I, at 16, § 8 (January 25, 1990) [hereinafter Joint Venture Ordin-
ance]. For a more detailed discussion of the Joint Venture Ordinance, see Buchholz & Sternal,
Ausgewählte Rechtsfragen bei der Gründung und Tätigkeit von Unternehmen mit ausländischer
Beteiligung in der DDR, 3/1990 NEUE JUSTIZ 92 (Mar. 1990); Hebing, Das neue Unternehmensrecht
tion was granted, foreign investors were not allowed to acquire less than 20% or more than 49% of
the equity capital of a joint venture. Joint Venture Ordinance, § 3.
the detriment of the particular national economic sector.\textsuperscript{61} Although joint ventures with foreign participation could acquire the right to use real property, they could not own real property.\textsuperscript{62}

Corporate entities (but not partnerships)\textsuperscript{63} were permitted to establish an annual tax deductible reserve of up to 10\% of stated share capital and to carry forward losses for up to a period of five years.\textsuperscript{64} These incentives, however, did not sufficiently offset the detrimental effects that extremely high East German tax rates and a host of other factors\textsuperscript{65} had on foreign investment, and only a handful of joint ventures were established.\textsuperscript{66} The Joint Venture Ordinance can ultimately be seen as a meager attempt to reform rather than to supplant the existing economic system, and it was repealed in conjunction with the passage of the MESU.\textsuperscript{67}

An additional law, the "Private Enterprise Law," was promulgated on March 7, 1990,\textsuperscript{68} in order to promote entrepreneurship among East German residents by permitting them to establish small and medium-sized businesses in the form of corporate entities or partnerships. The law also regulated state investment in private enterprises and private investment in state enterprises.\textsuperscript{69} This law among other things provided for the formation of new private businesses and the privatization of certain businesses that had been expropriated by the East German govern-

\begin{footnotes}
\item[61] Joint Venture Ordinance, § 13(1).
\item[62] Id. § 15(2).
\item[63] Joint ventures could be established in the form of a stock corporation ("Aktiengesellschaft"), a limited liability company ("Gesellschaft mit beschränkter Haftung" or "GmbH"), a commercial general partnership ("offene Handelsgesellschaft"), or a commercial limited partnership ("Kommanditgesellschaft"). Id. § 5(1)-(2). The formation of the joint ventures was governed by the Company Law and their operations by the Commercial Code. Id. § 15(3). These laws were pre-World War II versions of the same laws applicable in West Germany and due to East Germany's planned market economy had remained virtually unused until they were revived in 1990.
\item[64] Id. §§ 5(3), 22(2).
\item[65] These factors included: (i) the limitation of foreign participation at 49\%, whereas the actual value of foreign participation, irregardless of capital contribution, typically was greater in reality given the superior know-how, funding, intellectual property, and distribution systems; (ii) the almost complete discretion given to the East German government in accepting proposed joint ventures; (iii) the difficulty of identifying the actual East German business partner behind the archaic governmental apparatus in order for the joint venture to make important business decisions; and (iv) the lack of a sufficient commercial and legal infrastructure to permit efficient operation of a joint venture. See Werner Blau & Peter Rawert, East Germany: Legal Steps Toward a Market Economy, 5 INT'L BUS. LAW. 305, 307 (1990).
\item[66] Joint Venture Ordinance, § 29.
\item[67] Verordnung über die Änderung oder Aufhebung von Rechtsvorschriften, GBL.DDR I, at 509, § 12(1) (June 28, 1990).
\item[69] Id. § 2. The East German government could invest in private business entities by making either a cash or in-kind contribution. Id. § 4(1).
\end{footnotes}
ment in 1972.\textsuperscript{70} Private businesses were permitted to engage in any legal business activity and to establish foreign trade relations.\textsuperscript{71} As was also the case under the Joint Venture Ordinance, the private business entities could only acquire the right to use real property, but could not purchase real property located in East Germany.\textsuperscript{72}

B. Legal, Operational and Structural Overview

Given the scale of privatization which was required in order to transform the East German economy, a public trust ("Treuhand") was initially created by the East German government on March 1, 1990, in order to facilitate accelerated privatization and reorganization of all companies which had previously been state owned.\textsuperscript{73} It soon became clear, for a discussion of the 1972 expropriations, see infra section II(C)(3). The Private Enterprise Law also contained a number of provisions pertaining to the reprivatization of private business entities, mostly semi-public enterprises, which were transferred to state ownership in 1972. \textit{Id.} \S 17. Reprivatization of these business entities technically occurred through transformation into the legal form they had prior to their nationalization. The transformation of a semi-public enterprise would thus result in partial state ownership in a newly-formed private business entity, which the East German government was permitted to sell or transfer to private individuals. \textit{Id.} \S 19(2). Reprivatized business entities which owned real estate prior to their nationalization in 1972 were also able to request for retransfer of title to such real property. \textit{Id.} \S 17(1). In contrast to the Transformation Ordinance, \textit{infra} note 73, newly-formed private companies were not viewed under the Private Enterprise Law as the successors in title to their state-owned predecessor companies.

\textsuperscript{70} For a discussion of the 1972 expropriations, see infra section II(C)(3). The Private Enterprise Law also contained a number of provisions pertaining to the reprivatization of private business entities, mostly semi-public enterprises, which were transferred to state ownership in 1972. \textit{Id.} \S 17. Reprivatization of these business entities technically occurred through transformation into the legal form they had prior to their nationalization. The transformation of a semi-public enterprise would thus result in partial state ownership in a newly-formed private business entity, which the East German government was permitted to sell or transfer to private individuals. \textit{Id.} \S 19(2). Reprivatized business entities which owned real estate prior to their nationalization in 1972 were also able to request for retransfer of title to such real property. \textit{Id.} \S 17(1). In contrast to the Transformation Ordinance, \textit{infra} note 73, newly-formed private companies were not viewed under the Private Enterprise Law as the successors in title to their state-owned predecessor companies.

\textsuperscript{71} \textit{Id.} \S 9.

\textsuperscript{72} \textit{Id.} \S\S 4(1)-(3).

\textsuperscript{73} Beschluss zur Gründung der Anstalt zur Treuhandischen Verwaltung des Volkeigentums (Treuhandanstalt), GBl.DDR I, at 107 (Mar. 1, 1990) [hereinafter Treuhand Ordinance]. Contemporaneously with the promulgation of the Treuhand Ordinance, the East German government took the first bona fide step toward introducing private property rights on March 1, 1990, by enacting the Verordnung zur Umwandlung von volkseigenen Kombinaten, Betrieben und Einrichtungen in Kapitalgesellschaften, GBl.DDR I, at 107 (Mar. 1, 1990) [hereinafter Transformation Ordinance], which called for the complete dismantling of the planned economy. The Transformation Ordinance made it incumbent upon almost all the state-owned companies in East Germany to transform themselves into either stock corporations or limited liability companies. \textit{Id.} \S\S 1(1), 2(1). The shares of these newly-formed private companies were to be vested in the Treuhand, which was established through the contemporaneous Treuhand Ordinance on March 1, 1990. The Transformation Ordinance itself was limited solely to the procedure by which the state-owned companies would change their legal business form and did not provide for private property rights. The Transformation Ordinance was effectively repealed concurrently with the Joint Venture Ordinance on July 1, 1990. Verordnung über die Änderung oder Aufhebung von Vorschriften, GBl.DDR I, at 509, \S 12(9) (June 28, 1990). In conjunction with the Transformation Ordinance and the Treuhand Ordinance, an ordinance setting forth the initial charter for the Treuhand was also promulgated. Statut der Anstalt zur treuhandischen Verwaltung des Volkeigentums, GBl.DDR I, at 107 (Mar. 1, 1990).

Handicraft production cooperatives were also required to be privatized through the Verordnung über die Gründung, Tätigkeit und Umwandlung von Produktionsgenossenschaften des Handwerks, GBl.DDR I, at 164 (Mar. 8, 1990). This ordinance closely resembled the Transformation Ordinance. Nevertheless, due to the fact that handicraft production cooperatives were "cooperative property" as opposed to "public property" and legal title thus was vested in the cooperatives themselves, as opposed to the East German state, transformation did not require the use of a trust apparatus and
however, that the privatization process was not occurring fast enough to appease mounting political pressure, although by the end of June 1990 the transformation of approximately 3,400 state-owned companies had taken place. Although the Treuhand was vested with the right to transfer and sell the share capital of transformed companies, it had only been authorized up to this point to transfer and sell shares in order to establish or enlarge small and medium-sized companies formed pursuant to the Private Enterprise Law, which comprised only a small portion of the overall economic sector in East Germany. In order to correct this and other problems, the underlying legislation and charter of the Treuhand were amended prior to reunification, and the Unification Treaty then incorporated a slightly modified Treuhand into the law of the united Germany. As a result, the Treuhand became a government trust affiliated with the Federal Tax Ministry and the Federal Economic Ministry.

The Treuhand has had a relatively short but turbulent history, surviving through three separate governments and three disruptive structural changes. The means chosen to achieve privatization in the new federal states, namely the Treuhand, has not received universal acceptance and has become the subject of much criticism, and a number of could be accomplished directly. Cooperatives could also be transformed into partnerships in addition to corporate entities. A slightly varied version of this ordinance was later incorporated into the law of the united Germany through the Unification Treaty, supra note 1, app. II, chap. V, § A and then later amended by article 8 of the Gesetz zur Beseitigung von Hemmnissen bei der Privatisierung von Unternehmen und zur Förderung von Investitionen [PrHBG], BBl. I, at 766, 787 (Mar. 28, 1991) (so-called "Enthemmungsgesetz").


76 Unification Treaty, supra note 1, art. 25.

77 During the initial months of the Treuhand, it was generally less sensitive to social issues and
commentators have offered interesting alternative approaches, both with and without the Treuhand. Nevertheless, the Treuhand has become and will remain the main bulwark for privatization in the new federal states.

1. Companies and Other Assets Held by the Treuhand

The Treuhand is the world’s largest holding company. As of July 1, 1990, all state-owned enterprises in the new federal states (approximately 8,500), which had not already been transformed, were automatically transformed into either stock corporations or limited liability companies. The Treuhand, as fiduciary for the former East German government and later the united German government, became the interim shareholder of: (i) more than 150 combines ("Kombinaten") which are primarily holding companies; and (ii) either directly or indirectly through the combines, approximately 8,300 operating companies ("Betriebe") which comprise the vast majority of the new federal states' economic sector. The combines were transformed into stock corporations received much criticism for not taking into account factors other than the purchase price when selling off its businesses. Continuing protests and the assassination of the Treuhand’s president, Detlev Rohwedder, on April 1, 1991, by terrorists of the Red Army Faction led the Treuhand and the federal government to reevaluate its privatization policies. See Neues Image gesucht, 16/1991 WW 16 (Apr. 12, 1991); TREUHAND, BUYING COMPANIES, supra note 6, at 13; Stephen Kinzer, Facing Down Protests, Eastern Germany Goes Private, N.Y. TIMES, Nov. 3, 1991, at 8, col. 1. Although the Treuhand officially has not changed its approach to privatization, the practical result of the various occurrences in early 1991 is an approach which seeks to obtain a purchase package that maximizes long-term public welfare rather than gross sales proceeds. In addition, the federal government, the federal state governments, and the Treuhand in March 1991 established general guidelines which call for the Treuhand to work more closely with the affected federal state in its privatization decision making. Grundsätze zur Zusammenarbeit von Bund, neuen Ländern und Treuhandanstalt (Mar. 14, 1991), reprinted in TREUHANDANSTALT, AUFTRAG ZWISCHENBILANZ GRUNDSÄTZE 18 (June 1991) [hereinafter TREUHAND AZG].


80 See DBR, supra note 37, at 12; Passavant & Nösser, supra note 37, at 882-83.

81 DBR, supra note 37, at 12.

82 Treuhand Law, § 11(1). Those state-owned companies not requiring transformation included the Post Office, Railroad, Waterways Board, Administration of Public Roads, agricultural cooperatives, and municipal enterprises. Id. § 1(5).

83 In sharp contrast to West Germany, the East German economy had relatively no small or medium-sized businesses. A large part of East German gross national product was contributed by large combines which exercised vertical monopoly control over their respective market segments and often operated their own schools and social services. TREUHAND, BUYING COMPANIES, supra note
(“Aktiengesellschaft”) and the operating companies into limited liability companies (“Gesellschaft mit beschränkter Haftung”). Of these 8,500 companies, it was initially thought that roughly one-third were financially sound, one-third were capable of rehabilitation, and the remaining one-third would be liquidated. The overall number of companies is actually growing as a result of the breakup of many of the combines in order to enhance economic competitiveness, and the number of companies held by the Treuhand is currently estimated at roughly 5,400 (employing approximately 1.35 million persons), well over 70% of which are said by the Treuhand to be financially sound or capable of rehabilitation.
The Treuhand is currently undertaking negotiations with approximately 2,000 potential investors. As of the end of February 1992, the Treuhand had privatized approximately 6,300 companies (amounting to sales proceeds of roughly DM 73 billion). As a result, the Treuhand has been able to secure over one million jobs and has received assurances from investors that they will invest DM 130 billion in their newly-acquired businesses. As of the end of February 1992, the Treuhand also had liquidated or planned to liquidate approximately 1,200 companies and has predicted that this amount will rise rapidly in the coming months. In addition to more than 8,500 former state-owned companies, the Treuhand also became responsible for privatizing approximately 4.3 billion acres of land devoted to agriculture and forestry, 25,000 retail businesses, 7,500 hotels and restaurants, 900 book stores, and a large number of publishing firms, travel agencies and vacation homes. Ap-

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88 Privatisierung hilft am besten, SÜDDEUTSCHE ZEITUNG, Oct. 26, 1991, at 34, col. 1. In order to try to increase this number and help market some of its companies faster and more efficiently, the Treuhand, prior to September 1991, had commissioned 36 investment bankers on a short-term basis (on average 3 months) to make contact with potential investors in order to sell 133 of its companies.

89 See DBR, supra note 37, at 12; Privatisierung: Rekordzahlen im Oktober, 8-9/1991 TREUHANDINFO at 12. As of September, 1991, the Treuhand had received only DM 6.7 billion of the then overall sales proceeds of DM 13.9 billion. This was a result, however, of negotiated installment payments or certain payment obligations being conditioned on the resale of acquired businesses premises or operations. Id. The Treuhand projects 1992 sales proceeds to decrease to an overall sum of DM 12 billion, because the large purchases, such as department stores and hotels, can no longer be relied on in 1992. Treuhand erwartet 1992 höhere Defizit, SÜDDEUTSCHE ZEITUNG, Oct. 26, 1991, at 33, col. 2.

Of those companies already privatized as of mid-1991, roughly: (i) 40% were in mechanical engineering and heavy industry; (ii) 28% were in the food industry; (iii) 17% were in electronic, precision and optical goods production; and (iv) 12% were in chemical and industrial rubber works.

90 DBR, supra note 37, at 12-13; Privatisierung: Rekordzahlen im Oktober, 8-9/1991 TREUHANDINFO at 12. As of September 1991, the companies held by the Treuhand also planned to recapitalize an overall amount of DM 15 billion. See Mindestens 70 Prozent der Treuhand-Unternehmen sind sanierungsfähig, supra note 87 at 4.

91 DBR, supra note 37, at 12. As of October 1991, the Treuhand had spent DM 8.3 billion in liquidating 800 companies, which included the costs for assuming debt obligations, personnel expenses, and environmental cleanup. Treuhand benötigt 1992 mehr Spielraum, 7/1991 TREUHANDINFO 2; Treuhand erwartet 1992 höheres Defizit, supra note 89, at 33. Although over 100,000 jobs were affected by the 800 liquidations, between 30-40% of such jobs were or are capable of being saved through “creative liquidations” in which the Treuhand finds purchasers for the particular assets or departments of a liquidated company and these entrepreneurs continue or initiate new business activities, albeit on a lesser scale. Neues Leben in der Liquidation, 5/1991 TREUHANDINFO 11.

92 10,000 Firmen zu verkaufen: So knacken Sie die Treuhand, 3/1991 IMPULSE 16.
proximately 22,000 of these small businesses had been privatized as of May 1991 and only 1,500 had to be shut down. Furthermore, it is estimated that an additional 600,000 new businesses will have been formed by the end of 1991.

2. Responsibilities

The transformation and transfer of ownership of state-owned companies under the Treuhand Law envisages two separate steps: (i) the transformation of state-owned companies into either stock corporations or limited liability companies; and (ii) the disposal by the Treuhand, as fiduciary for the State, of the equity capital of the newly-formed companies. The Treuhand is thus called upon to act as the interim shareholder of these newly-formed companies and to sell the shares of financially sound or rehabilitated companies after they have been transformed from state-owned companies.

Upon transformation, the newly-formed companies acquire legal title to the assets at the disposal of their predecessors. Nevertheless, the proprietary rights of the newly-formed companies to real estate and their other assets may be subject to claims for restitution or indemnification by persons whose property was illegally confiscated or nationalized. Over one million such claims for restitution have been filed by former owners.

The general objectives of the Treuhand are: (i) rapid and extensive privatization of the Eastern German economy in order to reduce the economic role of the federal government; (ii) securing existing jobs and the creation of new jobs as well as increasing the competitiveness of as many businesses as possible; (iii) making real property available for economic development; and (iv) liquidating businesses which are not capable of becoming competitive.

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93 22,300 HO-Geschäfte privatisiert, 5/1991 TREUHANDINFO 3. As of May 1991, these included 100% of all department stores, 70% of small stores, cafes, and restaurants, and 60% of pharmacies located in the new federal states. TREUHAND AZG, supra note 77, at 26.

94 See ACC, OPPORTUNITIES AND OBSTACLES, supra note 15, at 12. 280,000 new businesses were founded in 1990 and only 30,000 of these folded in the same year. TREUHAND, BUYING COMPANIES, supra note 6, at 16.

95 Treuhand Law, § 11(2). The transformations occurring on or before July 1, 1990, created "companies under construction" ("Gesellschaften im Aufbau") without a charter, a board, or permanent management. Id. § 14. Management of these companies under construction continues to be handled temporarily by the former managers, unless substitutes acting on behalf of the Treuhand have been appointed. Id. § 16(1).

96 Id. § 8(1).

97 Id. § 11(2).

98 See infra section II(c)(3)(a).

99 For a detailed discussion of this topic, see infra section II(C)(3)(a)(ii).

100 Treuhand Law, pmbl.
clude realistic asset valuation, investigating whether and under which circumstances particular companies can be restored to financial viability, decartelization of formerly state-owned companies, and the infusion of liquidity into those companies targeted for restoration. The Treuhand is authorized to provide, through loans and guarantees, the funds required to overcome the present illiquidity of many of these companies and to rehabilitate those companies whose financial viability can be restored. The Treuhand must also liquidate companies that cannot be restored to financial viability. The decision of whether to rehabilitate or liquidate a weak company is based upon an evaluation of asset composition, net worth, prospective earnings, and growth potential. The ability of the Treuhand to discharge its financial obligations depends upon the amount of proceeds it collects from the privatization and liquidation of the companies held in trust, as well as the financial assistance it receives from the federal government. The Treuhand has estimated that its 1990/1991 deficit will amount to DM 25.1 billion and its 1992 deficit is expected to increase to DM 31.5 billion. The line of credit extended to the Treuhand from the federal government was DM 25 billion for 1990/1991 and will be DM 30 billion per year for 1992 through 1994.

The Treuhand is also responsible for transferring the ownership of

101 Id. § 8(1).
102 Id.
103 Id. § 2(6); Company Splitting Law, § 1.
104 Second Charter, § 4(1).
105 Id. § 2(7).
106 Second Charter, § 3.
107 Treuhand benötigt 1992 mehr Spielraum, supra note 91, at 2. The Treuhand projects an accrued income of DM 18.5 billion and an indebtedness of DM 43.6 billion covering its numerous obligations vis-a-vis investors and formerly state-owned companies. Id. The projections for 1992 are extremely tenuous. For example, a 1% increase in the average salary level for businesses held by the Treuhand would increase the payment obligations by DM 500 million. Treuhand erwartet 1992 höheres Defizit, supra note 89, at 33. The Federal Economic Ministry has estimated that the Treuhand’s overall future debt burden could amount to more than DM 300 billion, but if the Treuhand’s projected privatization costs sizably increase, this amount could mushroom. See Horrende Schulden, supra note 87, at 24; DBR, supra note 37, at 14.
108 Unification Treaty, supra note 1, art. 25(4).
109 See DBR, supra note 37, at 14. The federal cabinet originally proposed this government credit limit in a draft law, in order to prompt the Treuhand to manage its finances more efficiently. See Treuhand zur sparsamen Kreditaufnahme verpflichtet, Süddeutsche Zeitung, Dec. 12, 1991, at 31, col. 3; Bundesregierung bestätigt Treuhand Kurs, 8-9/1991 TREUHANDINFO 2. In order to meet its financing needs, the Treuhand has utilized primarily bank loans and commercial paper. Commercial paper issued by the Treuhand now amounts to DM 10 billion or roughly 40% of the German commercial paper market. DBR, supra note 37, at 14-15. Although the Treuhand is currently not legally authorized to float public bond issues, there is much discussion in the German government with respect to granting the Treuhand the same authority as the federal government to issue public bonds. Id. at 14.
part of the real property it holds to the towns, cities, and municipalities in the new federal states. Until recently, the Treuhand had been harshly criticized in the media for not consulting local governments when making sales decisions and for dragging its feet in providing local governments with enough real property to undertake regional planning in order to encourage local entrepreneurship and investment in their communities. In the face of this criticism, the Treuhand has promised to closely consult local and federal state authorities in its decision-making. In response, the federal states have created special committees to interface with the Treuhand concerning major projects within their respective territories.

Prior to October 1991, such local authorities had submitted over 100,000 requests for property transfer and an additional 200 such requests were received daily. The Treuhand is responsible for handling roughly one-third of these requests and the federal state authorities for the remainder. Approximately half of these applications had been processed and 1,430 transfers had been approved as of October 1991.

3. Organizational Structure

The underlying legislation envisaged a decentralized trust structure in which the Treuhand would create stock corporation subsidiaries, to which it would transfer the shares of the newly-transformed companies that it acquired upon their transformation on or before July 1, 1990. The new charter of the Treuhand outlined five subsidiaries which were to separately hold the equity capital of companies in consumer goods, manufacturing, heavy industry, machinery and equipment manufacturing, trade or services, and agriculture or forestry. Nevertheless, this organizational structure of subsidiaries was never adopted by the Treuhand.

Instead, the main office of the Treuhand, located in Berlin, established fifteen branch offices which were given the task of privatizing companies held by the Treuhand with less than 1,500 employees. This

110 For a good overview of the legal and administrative issues regarding this matter, see TREUHANDANSTALT, FRAGEN UND ANTWORTEN ZUR ÜBERTRAGUNG VON VERMÖGENSWERTEN AN STÄDTE, GEMEINDEN UND LANDKREISE (June 1991).
112 Id. at 17.
113 See TREUHANDANSTALT, PROMOTING THE NEW GERMANY 8 (1991) [hereinafter TREUHAND, PROMOTING THE NEW GERMANY].
115 TREUHAND AZG, supra note 77, at 10.
116 Vermögens-Übertragung läuft auf vollen Touren, supra note 114, at 14.
117 Treuhand Law, §§ 7-10.
118 Second Charter, § 5.
119 See Möschel, supra note 78, at 183; Siegen, supra note 75, at 12.
enabled the Treuhand to have closer contact with its small to medium-sized companies throughout the new federal states.\textsuperscript{120} As a result, the main office in Berlin became primarily responsible for privatizing larger companies and for the Treuhand’s executive management. The Treuhand headquarters is organizationally structured with the offices of the President, presently Birgit Breuel,\textsuperscript{121} overseeing eight separate departments, in order to allow Treuhand employees to gain expertise in specific business sectors and to allow the branch offices to gain easy access to such expertise. Six of the Treuhand’s departments have both functional and specific business sector responsibilities, one department handles the personnel and social matters for the Treuhand and the companies it holds, and one department oversees the Treuhand’s numerous financial activities. Eight top Western German managers run each of these departments.\textsuperscript{122} The management board ("Vorstand") consists of the President and the eight department heads and manages the Treuhand on a team basis.\textsuperscript{123} In addition, a supervisory board comprising of proven leaders drawn from the private business sector, trade unions, and federal and local politics, keeps a watchful eye on the Treuhand’s activities.\textsuperscript{124} The management board of the Treuhand reports directly to the supervisory board, which must approve major operational decisions and fundamental policy issues to be undertaken by the management board.\textsuperscript{125} The Treuhand is also supervised by the Federal Ministries of Economics and Finance, as well as special committees established by the two houses of the German parliament.\textsuperscript{126}

There are fifteen Treuhand branch offices between Rostock in the north and Dresden in the south. Each branch office contains an advisory council comprised of representatives from the local and federal state governments, business associations, local chambers of commerce, unions, churches, and public interest groups, in order to facilitate the exchanging of ideas on fundamental issues between these interest groups and the

\textsuperscript{120} Weimar, \textit{Treuhandanstalt und Treuhandgesetz}, 12/1990 RIW (DDR RECHTSENTWICKLUNGEN) Folge 17:10 at 12 (Dec. 1990). The main office and the fifteen branch offices currently have a total of approximately 3,000 employees. \textit{TREUHAND, BUYING COMPANIES}, supra note 6, at 13.

\textsuperscript{121} Birgit Breul was active in politics before joining the Treuhand at its inception in 1990. She served on the Hamburg City Council for eight years and then served both as the Economics Minister (1978-1986) and the Finance Minister (1986-1990) in the Western German federal state of Lower Saxony. She also has served on the boards of a number of corporations, including Volkswagen AG. Since April 1991, she has served as President of the Treuhand. \textit{See Birgit Breul: Klares Programm}, 16/1991 WW 16 (Apr. 12, 1991).

\textsuperscript{122} TREUHAND, BUYING COMPANIES, supra note 6, at 26.

\textsuperscript{123} \textit{See TREUHAND, PROMOTING THE NEW GERMANY}, supra note 113, at 17.

\textsuperscript{124} \textit{See Unification Treaty}, supra note 1, art. 25(2); Treuhand Law, § 4(1).

\textsuperscript{125} \textit{See TREUHAND, PROMOTING THE NEW GERMANY}, supra note 113, at 7.

\textsuperscript{126} \textit{Id.}
The branch offices handle roughly two-thirds of all companies entrusted to the Treuhand and are given the following general tasks and responsibilities: (i) overseeing approximately 300 small or medium-sized limited liability companies; (ii) the similar authority and responsibilities granted to branch offices of Germany's large commercial banks; (iii) privatization and liquidation; (iv) reprivatization of companies nationalized in 1972; and (v) the granting of loans, credits, and guarantees up to predetermined limits.

Initial fears that strong preferences would emerge among potential investors for companies in particular new federal states has proven to be unfounded. Investors have perceived investment opportunities in each federal state, and an example of this phenomenon is the fact that investor interest has been above average for the low populated regions in the new federal states. Many of the Treuhand branch offices plan to wind up their operative sales activities by the end of 1992, although they will continue thereafter to administer existing contracts and advise companies on available financing and assistance programs. During this interim period, however, the companies still held by the branch offices will require much more intensified assistance from the branch offices than those which have already been sold.

The Treuhand also formed two subsidiaries in order to privatize real estate and the small trade businesses it holds. One subsidiary ("Liegen-schaftsgesellschaft der Treuhandanstalt mbH (TLG)") was established in order to oversee the privatization of commercial real estate in the new federal states. If real property has been separated from the assets of a company held by the Treuhand, the TLG typically becomes responsible for privatizing such real property. As of November 1991, the TLG held 9,096 out of an estimated overall 25,000-30,000 parcels of real property held by the Treuhand (or roughly one-third).

Up to that point in time,
the Treuhand had sold 4,256 parcels for an overall amount of DM 3.9 billion and had additionally secured DM 29.7 billion in investment guarantees and 196,184 jobs with respect to such parcels.136

Another Treuhand subsidiary ("Gesellschaft zur Privatisierung des Handels mbH") was established to privatize the great majority of the small trade businesses held by the Treuhand.137 As of August 1991, this Treuhand subsidiary had, as a practical matter, completed its task by selling 22,300 out of approximately 30,000 small businesses on a lease installment basis.138 Only 1,500 shops and restaurants had to be closed due to bad location, inadequate or inferior business premises, or poor investor interest.139 Approximately 6,000 potential privatizations could not take place, because either local government or former owners did not give their approval to such transactions.140

4. Insider Rules

As is unfortunately expected in large bureaucratic institutions, the Treuhand is said to have experienced a minor amount of self-dealing by some of its employees in its earlier stages. As a result, the Treuhand has recently issued "insider rules" to ensure that no unfair advantages in acquiring or managing a business held by the Treuhand are exploited by its employees or any other "persons who due to their job position have or could have information which is not publicly available or could make or influence decisions of the Treuhand."141 Insiders wishing to conduct business with the Treuhand must now initially inform their respective superiors of their intentions, who in turn must decide whether a contemplated transaction falls within the purview of the insider rules. If the superior finds this to be the case, he is to inform a special panel which will review the matter.142 If it is uncovered that an insider knowingly did not disclose or was grossly negligent in not disclosing his insider activities, or in any other way wrongfully took advantage of his position, any concluded transactions with the Treuhand may be retroactively re-

138 Id.
139 Id.
140 Id.
141 Insider-Regeln der Treuhandanstalt, § 1, republished in 7/1991 TREUHANDINFO 10 [hereinafter Insider Rules]. See also Insidergeschäfte unter strenger Kontrolle, 7/1991 TREUHANDINFO 7. Insiders are broadly defined to include: (i) employees and board members of the Treuhand and its affiliated entities; (ii) partners and employees of firms working closely with the Treuhand (i.e., accountants, tax and management consultants, brokers, investment bankers, lawyers, etc.); (iii) all spouses or relatives thereof; and (iv) all business entities of which an insider holds more than a 50% interest or effectively controls. Insider Rules, §§ 2-5.
142 Insider Rules, §§ 6-8.
scinded and/or such insider may be legally prosecuted.\textsuperscript{143} Although these insider rules are certainly not foolproof, they are a large step in the right direction given the fact that Germany has yet to adopt insider trading legislation. Such legislation is expected to be passed by mid-1992, however, largely as a reaction to a highly publicized insider trading scandal which recently took place in Frankfurt, Germany's financial center, in which all involved could not be indicted because their activity was found not to be illegal under German law.\textsuperscript{144}

C. Negotiations With the Treuhand

To date, roughly 95\% of all businesses sold by the Treuhand have been sold to German investors, and the remaining 5\% have been acquired by foreign investors.\textsuperscript{145} Many of the foreign investors from non-EC countries who have already invested in the new federal states perceive the new federal states both as an attractive region in which to establish an EC presence and as a springboard into Eastern Europe.\textsuperscript{146} Nevertheless, as of the end of February 1992, U.S. investors had only acquired 19 out of 322 such businesses, which translates into a mere 6\% of foreign acquisitions (or 0.3\% of all acquisitions).\textsuperscript{147} These figures, however, only effectively represent a small portion of U.S. direct investment into the new federal states, and it is estimated that over 140 U.S. companies are involved there in some form of business, including branch offices, subsidiaries, and joint ventures.\textsuperscript{148} Even so, the magnitude of U.S. investment into the new federal states is much lower than originally expected.\textsuperscript{149}

Plausible explanations for meager U.S. investment levels up to this point may be: (i) the fact that the United States is currently experiencing an economic recession and that many potential U.S. investors feel that, although business opportunities do exist, there are currently too many

\textsuperscript{143} Id. §§ 9-14.
\textsuperscript{144} See IL&T, supra note 9, at 20.
\textsuperscript{145} See DBR, supra note 37, at 12, 15; Privatisierung: Rekordzahlen im Oktober, supra note 89, at 12. As of the end of February 1992, foreign investors had acquired 322 out of roughly 6,300 companies sold by the Treuhand. In connection with these 322 acquisitions, foreign investors had given investment guarantees amounting to DM 10.545 billion and job guarantees for 95,840 jobs. Id. at 15.
\textsuperscript{147} DBR, supra note 37, at 15. These nineteen companies were acquired by U.S. investors such as: Ford, General Motors, Phillip Morris, Reynolds, Coca-Cola, Procter & Gamble, and Otis. Internationales Engagement nimmt zu, 5/1990 TREUHANDINFO 18. The above figures vary, however, depending on the source of data and on the categorization of Western German subsidiaries held by foreign parent companies in making the applicable calculations.
\textsuperscript{148} U.S. Engagement Understated, COMMERCE IN GERMANY, Nov. 1991, at 4. See also U.S. Companies in the GDR, COMMERCE IN GERMANY, Aug. 1990, at 42.
\textsuperscript{149} U.S. Companies in the GDR, supra note 148.
uncertainties and unknowns in the new federal states (such as property ownership issues and environmental cleanup and liability issues)\textsuperscript{150} to warrant a sizable investment given economic problems at home;\textsuperscript{151} (ii) a perceived inadequacy of reliable information about specific investment opportunities and the general investment climate in the new federal states;\textsuperscript{152} (iii) the preoccupation of most U.S. investors with short-term rather than long-term returns on investment;\textsuperscript{153} (iv) Germany's relatively high tax rates;\textsuperscript{154} (v) the current lack of a modern infrastructure,\textsuperscript{155} and (vi) the possibility that U.S. investors may be seeking more attractive investment opportunities elsewhere.\textsuperscript{156} Another factor that has also probably contributed to low U.S. investment is misinformation that has been disseminated in the U.S. media over the past few years about the new federal states and their social and commercial viability.\textsuperscript{157}

\begin{itemize}
\item\textsuperscript{150} For a detailed discussion of these topics, see infra sections II(C)(3).
\item\textsuperscript{151} Thomas L. Boam, \textit{East Germany: Where are the Americans?}, \textit{COMMERCE IN GERMANY}, Apr. 1991, at 6 (an article written by the U.S. Embassy's commercial officer in Berlin). \textit{See also} ACC, OPPORTUNITIES AND OBSTACLES, supra note 15, at 28-38 (discussing other explanations for meager U.S. investment).
\item\textsuperscript{152} \textit{See} Passavant & Nösser, supra note 37, at 899; \textit{Bisher ein Fünftel der Privatisierungen zugunsten von Ausländern}, \textit{Frankfurter Allgemeine Zeitung}, Nov. 27, 1991, at 18, col. 1.
\item\textsuperscript{153} \textit{See} U.S. Engagement Understated, supra note 148, at 4.
\item\textsuperscript{154} \textit{Why Germany is Losing its Appeal for U.S. Investment}, \textit{COMMERCE IN GERMANY}, Nov. 1991, at 10.
\item\textsuperscript{155} \textit{See} Irwin, \textit{President's Podium: A Positive Opportunity for German and American Business}, \textit{COMMERCE IN GERMANY}, Nov. 1991, at 36.
\item\textsuperscript{156} \textit{Why Germany is Losing it's Appeal for U.S. Investment}, supra note 154, at 10.
\item\textsuperscript{157} For example, a March 1991 article in the Journal of Commerce, a widely read journal, described the privatization process in the new federal states as follows:
\begin{quote}
At the heart of the problem is a \textit{scrap heap} of 8,000, formerly state-owned, East German enterprises that can't compete with their modern Western counterparts.
\end{quote}
\begin{quote}
Company sales... are administered by the Treuhand, a privatization agency that is aggressively trying to sell the companies at \textit{bargain basement prices} to any interested parties in hopes of luring investment and creating jobs.
\end{quote}
\begin{quote}
Many investors, however, are balking, despite price tags that can amount to no more than \textit{pocket change}. The major stumbling block has been \textit{potentially massive liabilities}.
\end{quote}
\end{itemize}

Although there are admittedly still a number of potential pitfalls for U.S. investors and the clear majority of the businesses in the new federal states are in need of reorganization and modernization, the excerpt above is typical of many articles in the U.S. media which fail to give an objective and fair account of the privatization process and the current state of events in the new federal states. The Treuhand is not unaware of the criticisms and misinformation circulating in the public about itself, and is making efforts to inform the public about its sales and other practices and activities, as the following excerpt from Treuhand promotional material shows:

\begin{quote}
Many members of the public have difficulty in understanding why the Treuhand's revenue from some purchases is often so small, sometimes amounting to just one Deutsche mark.
\end{quote}

\begin{quote}
Such sales generally occur when the proposed site is heavily polluted or when there is no other way to find a new owner for the company willing to undertake the required invest-
A number of foreign investors, such as Coca-Cola and Phillip Morris, have had positive experiences in dealing with the Treuhand and in setting up business operations in the new federal states. Nevertheless, other potential U.S. investors who have sought to make investments in the new federal states through the Treuhand have complained of excessive red tape, decisions moving too slowly, decisions being changed after interested investors thought deals had already been concluded, and pro-German favoritism in decision making. Although most of the U.S. companies that have invested in the new federal states up to this point had previously established a business presence in West Germany and are likely to be just as familiar with German customs, laws, and markets as their West German counterparts, the majority of interested foreign investors lack such knowledge. As a result, it is highly recommended that those seriously contemplating investment obtain skilled local legal representation in dealings with the Treuhand in order to ensure that potential cultural and other misunderstandings are avoided and that an Eastern German business is acquired on a sound legal and financial basis which will enhance its chances for future economic growth and success.

Although the Treuhand is not without its problems and has undoubtedly made blunders in dealing with potential foreign investors, it is often an easy scapegoat due to its central role in the privatization process. A recent article in a leading English business magazine whimsically explained this scapegoat phenomenon as follows:

Set up to privatise the shambolic economy of eastern Germany, the Treuhandanstalt is the world’s largest holding company — and all Germany’s favourite football. The bleaker the economic news from the east, the harder the Treuhand gets kicked.

Investors complain that it is bureaucratic, economists that it

ment and secure jobs. Similarly, if the enterprise being taken over is heavily indebted and a new owner can only be found on condition that all or part of the debts are written off before privatization, such token prices are agreed upon.

Here speed is of the essence. The more rapidly these companies come under new management with new concepts, the sooner these companies will be able to compete for their share of the world’s markets— and the sooner jobs will become more secure.

Delaying privatization would merely waste precious time and squander opportunities.

TREUHAND, PROMOTING THE NEW GERMANY, supra note 113, at 11.

158 See Bisher ein Fünftel der Privatisierungen zugunsten von Ausländern, supra note 152, at 18.
160 See ACC, OPPORTUNITIES AND OBSTACLES, supra note 15, at 32; IL&T, supra note 9, at 5-6.
161 See Anthony Lee, Can German and U.S. Business Cultures Ever Find Common Ground?, COMMERCE GERMANY, Nov. 1991, at 6. Six of Germany’s largest fifty companies are controlled by U.S. parent companies and include Opel (General Motors), Ford, IBM, Esso, Phillip Morris, and Mobil Oil. See IL&T, supra note 9, at 3-4.
feather-beds firms unfit to survive, trade unions that it is too ready to make quick sales for next to nothing. Tenants and the unemployed call it heartless. All to nods from politicians happy to let the Treuhand take the blame which otherwise would come their way. . . .

Foreigners claim that, although there is no formal "Germans first" policy, a west German mafia is at work pushing what pearls there are to cronies back home. In contrast, some west German businessmen claim that, in its keenness to pull in foreign competition, the Treuhand has rejected good offers from home teams.162

When dealing with the Treuhand, potential investors should above all keep in mind the enormity of the task the Treuhand must accomplish (which has never previously been attempted, or even contemplated, on the same scale). The staff of the Treuhand is well aware of the various criticisms that have been leveled against it, is continuingly learning from its mistakes, and has shown a genuine interest in continually improving its performance.163

1. Preliminary Steps

The initial step should be to weigh the pros and cons of investing in the new federal states. Although immediate investment in the new federal states certainly entails more financial risk than waiting for economic conditions to stabilize, this consideration must be weighed against the possibility of lost opportunities, increased barriers to market entry, and saturated markets. In undertaking their investment analysis, interested investors should also consider investment in alternative sites in Western or Eastern Europe and/or initially establishing or expanding exports to the new federal states in lieu of direct investment.

Once a decision to consider investing in the new federal states has been reached, the next step is to obtain the most complete and up-to-date information available concerning potential investments. The Treuhand is understandably the best source of such information. In order to increase its visibility in the United States and to overcome some of the psychological barriers potential U.S. investors may have regarding investment in the new federal states, the Treuhand opened a New York office in November 1991 and has noticeably increased its marketing activities in the United States.164 Information concerning specific companies held by the Treuhand can be obtained from all Treuhand offices (including New

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164 The Treuhand's New York offices are located at 599 Lexington Avenue, 39th Floor, New York, N.Y. 10022, Tel. (212) 909-8159/8198, Fax (212) 909-8158. As a result interested American investors may benefit from better access to information concerning potential investment opportunities. The Treuhand's headquarters are located at Leipzigerstrasse 5-7, O-1080 Berlin, Germany, Tel.
York) and all German chambers of commerce, both in Germany and abroad. Further information can be obtained by regularly reading major German or international newspapers for solicitations for the public auction of companies held by the Treuhand or by contacting one of the major American investment banking firms currently working with the Treuhand. In addition, the American Chamber of Commerce in Germany may also be a good source of information and references.

Furthermore, the Treuhand is prepared to offer serious investors, especially foreign investors, the assistance of a Treuhand representative to act both as a guide and organizer of a potential company acquisition. A number of Americans currently employed with the Treuhand may also serve as a good source of information and may be willing to act as liaisons between an interested U.S. investor and the Treuhand.

Once an interested investor has gained access to sufficient information regarding potential investments, one or more companies held by the Treuhand should be targeted for acquisition. At this point, the targeted company and the Treuhand should be contacted, and due diligence should be undertaken shortly thereafter.

2. Written Offer and Selection Criteria

After due diligence has successfully been completed, a written of-
fer should be submitted to the Treuhand. The Treuhand has expressed a strong preference for purchase price optimization rather than purchase price maximization, meaning that factors other than the purchase price are taken into account in maximizing net proceeds, given the Treuhand’s role as a fiduciary for the federal government. In addition to a purchase price, a written offer should include: (i) a comprehensive business plan covering business objectives, the number of jobs to be safeguarded or created, projected financing, investment and modernization plans or guarantees, measures and financing to be undertaken for environmental cleanup, if any, and expected business relationships with suppliers and clients; (ii) a credit rating; and (iii) a legal opinion showing that the purchase will not violate German or EC competition law.17

In evaluating a purchase offer, the Treuhand generally considers the number of safeguarded or created jobs, the amount of anticipated or guaranteed investment, assumption of some or all of the costs of environmental cleanup, if any, the transfer of technology and know-how, and the business acumen and solvency of the investor.171 If more than one investor expresses interest and each investor offers roughly the same purchase price, the Treuhand may use either of the following evaluation methods: (i) capitalized value, which is the present value of projected future cash flows; and (ii) intrinsic value, which is the overall present market value of a company’s assets and liabilities. Given the difficulty in projecting future yields for businesses in the new federal states due to a lack of reliable market-oriented data, the intrinsic valuation method is more likely to be applied. Of course, the arrived at purchase price will also be increased or reduced to take into account liabilities assumed by the Treuhand or investor.172

170 TREUHAND PRIVATIZATION, supra note 169, at 7; TREUHAND, INVESTING IN EASTERN GERMANY, supra note 2, at 13. For a discussion of the German and EC competition laws currently applicable in the new federal states, see infra Section IV(C).

171 Leitlinien der Geschäftspolitik der Treuhand ("Treuhand Operational Guidelines"), § I(5), reproduced in BMWi, ASSISTANCE PROGRAMS, infra note 384, at 152-54; TREUHAND, PROMOTING THE NEW GERMANY, supra note 113, at 5. The final purchase price is typically the result of negotiations between an investor and the Treuhand. In making this determination, however, both parties use one of two (or both) of the following valuation methods: (i) capitalized value, which is the present value of projected future cash flows; and (ii) intrinsic value, which is the overall present market value of a company’s assets and liabilities. Given the difficulty in projecting future yields for businesses in the new federal states due to a lack of reliable market-oriented data, the intrinsic valuation method is more likely to be applied. Of course, the arrived at purchase price will also be increased or reduced to take into account liabilities assumed by the Treuhand or investor. TREUHAND, BUYING COMPANIES, supra note 6, at 11; Scheifele, Praktische Erfahrungen beim Unternehmensverkauf in den neuen Bundesländern (Zweiter Teil), 10/1991 BB 629, 629-30 (April 10, 1991) [hereinafter Scheifele II].
mix, the Treuhand will decide in favor of the investor which it perceives, all things being equal, to have the best business concept.\textsuperscript{172} The Treuhand has also expressed an interest in promoting entrepreneurship by offering entrepreneurs who acquire or manage a small or medium-sized company held by the Treuhand: (i) a preferred right to purchase if their bid is roughly equivalent to other bids; (ii) the right to waive a standard contract provision concerning reappraisal of real property (although such provision is no longer being required by the Treuhand main office); (iii) a cap on liability for environmental cleanup; (iv) a lease-to-own option for real property where outright purchase would otherwise have been a condition to the purchase of the company; (v) the right to have outstanding liabilities ("equalization reserves") remain unsecured on the books of an acquired company for a period of up to six years; and (vi) a guarantee for outstanding liabilities at customary bank rates and conditions for up to DM 3 million.\textsuperscript{173} The Treuhand also is actively seeking to promote management buyouts and buyins.\textsuperscript{174} Through November 1991, approximately 75\% of purchasers of companies held by the Treuhand have been entrepreneurs or small and medium-sized companies.\textsuperscript{175}

Although the Treuhand is obligated to sell its companies at or above their market price, the purchase mix for such companies is typically established through negotiations between a potential investor and the Treuhand. The Treuhand would prefer to receive a number of bids before making a sale decision, and even if individual negotiations with the Treuhand have already begun, the Treuhand will typically accept additional offers. The quality of the underlying business concept contained in a bid rather than the timing of such bid is important to the Treuhand.\textsuperscript{176} Negotiations on behalf of the Treuhand will typically be conducted by a project team consisting of a management consultant, an accountant, and a lawyer, and negotiations should take no longer than six months and often can be completed in a matter of weeks.\textsuperscript{177}

3. Important Issues in Negotiations

Due to the scope of this article, a detailed analysis of all the poten-

\textsuperscript{172} \textsc{Treuhand Privatization, supra} note 169, at 8; \textsc{Treuhand, Investing in Eastern Germany, supra} note 2, at 13.

\textsuperscript{173} \textsc{Treuhand Privatization, supra} note 169, at 8; \textsc{Treuhand, Investing in Eastern Germany, supra} note 2, at 14; \textsc{Treuhand AZG, supra} note 77, at 23-28.

\textsuperscript{174} \textsc{Treuhand Privatization, supra} note 169, at 12-13. \textit{See also} \textsc{BDI, Entrepreneurship, supra} note 33, at 2.

\textsuperscript{175} \textit{See Der Mittelstand ist Hauptkunde der Treuhand, Frankfurter Allgemeine Zeitung, Dec. 3, 1991, at 17, col. 1.}

\textsuperscript{176} \textsc{Treuhand, Buying Companies, supra} note 6, at 10.

\textsuperscript{177} \textit{Id.} at 27; Scheifele I, supra note 169, at 558.
tial points of contention that could arise when negotiating with the Treu-
hand is not possible. Nevertheless, a number of major issues are quite 
common in negotiations with the Treuhand and lend themselves to easy 
summary. It should be pointed out, however, that these issues and the 
analysis thereto found directly below also generally apply to an investor 
wishing to acquire or participate in a business in the new federal states 
which has already been privatized or is currently overseen by a govern-
mental institution other than the Treuhand.

Most acquisitions from the Treuhand are carried out on the basis of 
standard form contracts prepared by lawyers working for the different 
departments and branch offices of the Treuhand. As a result, these stan-
dard form contracts can often greatly differ from one another depending 
upon with which Treuhand office, department, or representative an inter-
ested investor undertakes negotiations.\footnote{178} Although these are form 
contracts, a prospective purchaser should seek to obtain certain modific-
tions or additions to such contracts with regard to the issues highlighted 
below during negotiations with the Treuhand.

\subsection*{a. Outstanding Property Claims}

The lack of legal clarity regarding property ownership issues in the 
new federal states has posed and continues to pose a major obstacle to 
investment.\footnote{179} Although these issues typically tend to be the most imme-
diate concerns for interested investors and the most conceptually difficult 
to understand, they are by their nature more easily correctable than some 
of the other potential investment impediments.

Unfortunately, the law currently in force with regard to these issues 
is an unruly mixture of legislation and regulations passed by the former 
East German government in 1990 and/or passed or amended by the 
united German government after unification. Thus, in order to better 
understand the current state of property ownership issues in the new fed-
eral states, the reader should have a general grasp of the legal and histori-
cal background of the evolution of property ownership rights in Eastern

\footnote{178} \textit{Treuhand, Buying Companies}, supra note 6, at 27.

Germany since the late 1930s.  

The territory comprising the new federal states has experienced numerous expropriations and nationalizations during the last half-century. For simplification purposes and given the scope of this article, the last two periods of expropriations and nationalizations in Eastern Germany will be addressed: the Soviet occupation (1945-1949) and the East German Communist regime (1949-1989).

(i). Legal Background  
(a). Soviet Occupation (1945-1949)

Beginning in October 1945, a series of expropriations took place under orders from the Soviet Military Administration (so-called “SMAD”). Property found in the Soviet occupation zone was initially sequestered and later expropriated as a result of its transfer into state ownership through legislative acts. These expropriations, which formally ended in April 1948, encompassed approximately 5,000 businesses, corresponding at the time to around 8% of recorded businesses and 40% of the industrial production in the Soviet occupation zone. They ordinarily occurred without compensation and with no opportunity for judicial review. Many of those victimized by the expropriations were individuals who were branded as so-called “Nazis” and “war criminals” in lists compiled by SMAD. In addition, the property of businesses that held “monopoly capital,” such as banks, insurance companies, utility companies, and mining and natural resource companies, was confiscated and later expropriated. Up to 1952, businesses which were connected through an “economic relationship” to previously expropriated businesses were also transferred into state ownership without compensation.

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180 This article does not address the series of expropriations and nationalizations which occurred after 1945 of property located in East Germany held by private individuals who either: (i) fled the Soviet occupation zone or Communist East Germany, (ii) resided in West Germany or West Berlin, or (iii) were non-German foreign investors. For an overview of these expropriations, see T. Kaligin & K. Goutier, Beratungshandbuch Eigentum und Investitionen in den neuen Bundesländern §§ 2200-2250 (1991).  
181 See SMAD Order No. 64 (Apr. 17, 1948).  
182 Lörler, Eigentumsordnung und Enteignung in der DDR, 2/1990 EWS 33, 34 (June 15, 1990); Rechtshandbuch Vermögen und Investitionen in der ehemaligen DDR, supra note 179, at 65.  
183 See SMAD Order No. 124 (Oct. 30, 1945). See also Kaligin & Goutier, supra note 180, at ¶ 2220; Rechtshandbuch Vermögen und Investitionen in der ehemaligen DDR, supra note 179, at 64-65; Thomerson, supra note 59, at 124.  
184 See SMAD Order No. 124 (Oct. 30, 1945); SMAD Order No. 97 (March 29, 1946). See also Kaligin & Goutier, supra note 180, at ¶ 2220; Klumpe & Nastold, supra note 179, at 5-6; Rechtshandbuch Vermögen und Investitionen in der ehemaligen DDR, supra note 179, at 3.
Much of the property expropriated during the Soviet occupation was approximately 3.3 million hectares (or about 36%) of the agricultural and forest land in the Soviet occupation zone which was expropriated for purposes of land reform.\textsuperscript{185} Parcels of land consisting of more than 100 hectares of land, consisting mostly of large estates, were expropriated without compensation for land reform purposes and parceled out to farmers or tradesmen, or transferred into state ownership.\textsuperscript{186}

Although many of the expropriations up to the end of the Soviet occupation resulted from legislation or regulations promulgated by the provisional government, the underlying order typically originated from SMAD.\textsuperscript{187}

(b). Communist Regime (1949-1989)

The German Democratic Republic was founded in October 1949. In the initial years of the East German Communist regime, private holders of business property were confronted with more subtle forms of economic coercion, such as tax discrimination, delivery prohibitions and supply obligations, and the revocation of business permits.\textsuperscript{188} This coercion often led to the sale of private businesses to the state, to bankruptcy, or to state equity participation.\textsuperscript{189}

As of 1956, private property extending to the means of production was permitted in East Germany but only through "semi-public enterprises," which were mostly commercial limited partnerships with a private individual acting as general partner.\textsuperscript{190} Equity participation on the part of the state was transferred into state ownership without any monetary compensation or other form of compensation.\textsuperscript{191} This hybrid business entity was officially justified as part of the necessary transition from capitalism to socialism.\textsuperscript{192} In 1972, however, these semi-public enterprises were finally transferred into complete state ownership by means of

\begin{itemize}
\item \textsuperscript{185} See Kaligin & Goutier, supra note 180, at ¶ 2210; Klumpe & Nastold, supra note 179, at 7-8; Rechtshandbuch Vermögen und Investitionen in der ehemaligen DDR, supra note 179, at 2-3.
\item \textsuperscript{186} Scheiße I, supra note 169 at 561.
\item \textsuperscript{187} See T. Kaligin & K. Goutier, supra note 180, at ¶ 2210; Klumpe & Nastold, supra note 179, at 7-8; Rechtshandbuch Vermögen und Investitionen in der ehemaligen DDR, supra note 179, at 2-3.
\item \textsuperscript{188} Rechtshandbuch Vermögen und Investitionen in der ehemaligen DDR, supra note 179, at 3, 66.
\item \textsuperscript{189} Id.
\item \textsuperscript{190} Verordnung über die Bildung halbstaatlicher Betriebe, GBlDDR I, at 253 (March 26, 1959) [hereinafter Semi-Public Enterprise Ordinance]. See also Rechtshandbuch Vermögen und Investitionen in der ehemaligen DDR, supra note 179, at 3-4.
\item \textsuperscript{191} Semi-Public Enterprise Ordinance, supra note 190, at 253.
\item \textsuperscript{192} Id.
\end{itemize}
a forced sale in exchange for relatively meager compensation, and thereafter the commercial property system in East Germany from 1972 to 1990 was based on the concept of “socialist property” (“Sozialistisches Eigentum”). By 1988, the following percentages of property in the main business sectors in East Germany were held as socialist property: (i) 97.6% of heavy industry; (ii) 92% of construction; (iii) 95.9% of farming and forestry; (iv) 98.2% of transportation, postal service, and telecommunications; (v) 91.6% of domestic trade; and (vi) 94.6% of all other industries.

(c). Events Since Early 1990

The East German government took the first major step toward introducing private property rights on March 1, 1990, by enacting the Transformation and Treuhand Ordinances, which called for the complete dismantling of the planned economy. These ordinances were effectively replaced on June 17, 1990, by the Treuhand Law, which reorganized the Treuhand in order to accelerate the privatization of state-owned property. The Unification Treaty then called for the continued application of a slightly modified Treuhand Law following reunification.

The Private Enterprise Act was enacted on March 7, 1990, to encourage the formation of private companies and to regulate state investment in private enterprises and private investment in state enterprises. This law, among other things, provided for the formation of new private businesses and the privatization of certain businesses that had been ex-


194 Socialist property consisted of three subgroups of property: (i) public property (“Volkseigentum”), the title to which was vested with the “people”, controlled by the state as the “political organization of the working class”, and could be utilized by public enterprises, public authorities, and combines but was not alienable or encumberable without prior government permission; (ii) cooperative property (“genossenschaftliches Eigentum”), which was owned by the cooperatives as legal persons; and (iii) property of socialist organizations (“Eigentum gesellschaftlicher Organisationen”), which was similar to cooperative property except that its title was vested in political parties and mass organizations. See Blau & Rawert, supra note 65, at 306; D. GRÄF, HANDBUCH DER RECHTSPRAXIS IN DER DDR No. 5 (1988); KLUMPE & NASTOLD, supra note 179, at 15-19; Lörler, supra note 182, at 35-36.

195 JAHRBUCH DER DEUTSCHEN DEMOB RATISCHEN REPUBLIK 1989, 99 (1989); Thomerson, supra note 59, at 125 n.18.
propriated by the East Germany government in 1972. Furthermore, the Private Enterprise Act permitted former owners of such businesses to demand restitution upon payment of an amount representing increases in the business's value.\textsuperscript{196} Nevertheless, businesses formed pursuant to the Private Enterprise Law could only acquire the right to use real property and could not purchase real property located in East Germany.\textsuperscript{197}

The MESU required the East German government to modify or abolish laws that were inconsistent with the ownership of private property and to ensure that real property rights could realistically be acquired.\textsuperscript{198} The MESU also outlined various general steps for the East German government to take in realizing these principles.\textsuperscript{199}

On July 11, 1990, the East German government issued regulations ("Registration Ordinance") which established groups of potential claimants, the types of property for which remuneration was to be permitted, and the procedure to be followed in filing a claim.\textsuperscript{200} Basically, all businesses, buildings and real property which were expropriated by the former East German government are to be returned to their former owners.\textsuperscript{201} Property expropriated by the Soviet occupying forces, however, was expressly excluded from restitution.\textsuperscript{202} The Registration Ordinance did not indicate, however, the form of compensation that was to eventually be granted for covered claims and merely stated that this issue was to be addressed by subsequent legislation.\textsuperscript{203}

Shortly after promulgation of the Registration Ordinance, the foreign ministries of the two Germanies issued a joint declaration on July 15, 1990 (the "Joint Statement"),\textsuperscript{204} which was attached to the Treaty on the Final Settlement With Respect to Germany signed by the Secretaries of State of the United States, the Soviet Union, the United Kingdom and France (commonly referred to as the "2+4 Treaty"). Although the

\textsuperscript{196} Private Enterprise Act, §§ 17-19.
\textsuperscript{197} Id. § 4(1)(3).
\textsuperscript{198} MESU, arts. 1(3), 2(2).
\textsuperscript{199} See id. Protocol, § A(II).
\textsuperscript{200} Verordnung über die Anmeldung vermögensrechtlicher Ansprüche, GBl.DDR I, at 718 (July 27, 1990) [hereinafter Registration Ordinance], as amended by Zweite Verordnung über die Anmeldung vermögensrechtlicher Ansprüche, GBl.DDR I, at 1260 (Aug. 30, 1990). Two weeks earlier, the East German government passed legislation granting non-East German residents, who were the victims of devaluation and forced loans in 1949 during the Soviet occupation as part of the 1948 Currency Reform, the right to receive compensation. Verordnung über die Tilgung der Anteilsrechte von Inhabern mit Wohnsitz ausserhalb der Deutsche Demokratische Republik an der Altguthaben-Ablösungsanleihe, GBl.DDR I, at 543 (June 27, 1990).
\textsuperscript{201} Registration Ordinance, § 1(1-3).
\textsuperscript{202} Id. § 1(4)(a).
\textsuperscript{203} Id. § 5.
\textsuperscript{204} Gemeinsame Erklärung der Regierungen der Bundesrepublik Deutschland und der Deutschen Demokratischen Republik zur Regelung offener Vermögensfragen, BGBl. I, at 1237 (July 15, 1990) [hereinafter Joint Statement].
Joint Statement did not specifically refer to the Registration Ordinance, it may be used as a set of general principles to interpret the Registration Ordinance given the content and the almost contemporaneous issuance of the two legal documents. These general principles were later codified into German law after unification. The Joint Statement also made it clear that no property wrongfully expropriated or nationalized between 1945 and 1949 was to be returned to former owners, although some form of compensation could be received for property taken during this period. Property nationalized after this period was to be returned wherever possible. This exclusion from restitution for victims of Soviet expropriations was reiterated in the Unification Treaty and was later held in April 1991 to be constitutional by the German Federal Constitutional Court.

Property rights in the new federal states were addressed in a number of the Unification Treaty's provisions. Article 41(1) of the Unification Treaty incorporated the Joint Statement of June 15, 1990, and article 41(2) further provided that a reconveyance of real property or buildings shall not take place if the real property or building affected is necessary for pressing investment projects that are important to the development of the economy of the new federal states, particularly the safeguarding or creation of jobs.

These Unification Treaty provisions and the Joint Statement, however, contained only general principles and avoided specificity wherever possible. Nevertheless, legislation specifically addressing property rights issues in some detail [hereinafter “Property Law”] entered into force concurrently with the Unification Treaty. The Property Law adopts

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205 These principles in the Property Law include: (i) restitution, as opposed to compensation, is the preferred remedy, unless compensation is the rightful claimant's remedy of choice or restitution is not otherwise practicable (§ 3); (ii) where property was sold or rented to East Germans in good faith, such individuals are to be given certain preferences (§§ 3(b), 5, 8); (iii) any property seized or held by the East German government is to be returned to its rightful owner (§§ 2, 6, 12); and (iv) compensation, and not restitution, is to be granted where property was properly condemned for public use (§ 3(a)).

206 Joint Statement, § 1.

207 Unification Treaty, supra note 1, chap. IX, art. 41(1) and appen. III.


209 Reproduced in Unification Treaty, supra note 1, appen. III.

210 Gesetz zur Regelung offener Vermögensfragen, BGBlI, at 1159 (Sept. 23, 1990), as last amended by PrHBG, art. 1. See generally Christmann, Offene Vermögensfragen und besondere Investitionen im Bereich der ehemaligen DDR, 1990 DStR 732.
the general principles found in the Joint Statement and the Unification Treaty and provides a legal and administrative framework for sorting out property ownership rights for property sought by former owners. The Property Law also generally provides for the right to receive restitution for property nationalized or expropriated during the Nazi regime (1933-1945), which includes property lost by individuals or associations as a result of persecution on the basis of race, political affiliation or ideology.\textsuperscript{211}

The Property Law, if applicable, generally calls for the reconveyance of property wrongfully expropriated or nationalized during the Nazi and East German Communist regimes.\textsuperscript{212} In this regard, investors are well advised to inform themselves from the outset about outstanding claims for restitution, if any, and to clear up any potential uncertainties concerning property ownership rights with respect to a particular asset or set of assets sought to be acquired or leased before entering into a contractual agreement. Even if a claim for restitution is outstanding, however, potential investors may benefit from a number of exclusions from the general preference for restitution set forth in the Property Law and in later legislation, which are outlined below in Subsections (4)(a)-(c).

(ii). Filing of Claims by Former Owners

Those individuals or legal entities victimized by nationalization or expropriation were given the opportunity last year to submit written claims for restitution which had to be filed for Nazi regime claims by March 31, 1991 and for Communist regime claims by October 13, 1991.\textsuperscript{213} Even if a former owner missed one of these two deadlines, most

\textsuperscript{211} Property Law, § 1(6).

\textsuperscript{212} Property which comes under the Property Law includes real property or rights therein, movable property, businesses and their assets located in Eastern Germany, proprietary/ participatory interests in operations or branches located outside of Eastern Germany, intellectual property rights, credit balances in bank accounts and other rights to monetary payments, and certain claims against debtors who previously resided in Eastern Germany. Property Law, § 2(2). Wrongful expropriations or nationalizations are generally defined in the Property Law as: (i) expropriation of property by the state for little or no value (§§ 1(1)-(2)); (ii) takings by the state through the use of deceit, fraud or other activities outside the rule of law (§§ 1(3), 1(6)-(7)); and (iii) continued state administration of property described in (i) and (ii) above (§§ 1(3)-(4)). For a discussion of what constitutes deceitful practices for purposes of the Property Law, see Kaligin & Goutier, supra note 180, at 2250.

\textsuperscript{213} Registration Ordinance, § 3. An initial deadline of January 31, 1991, was originally set for Communist regime claims, but this was later pushed back by a subsequent ordinance. Zweite Verordnung über die Anmeldung vermögensrechtlicher Ansprüche, GBl.DDR I, at 1260, § 3 (Aug. 21, 1990).

For a discussion of legal issues surrounding the filing of U.S. claims, see William Karl Wilburn, Filing of U.S. Property Claims in East Germany, 25 Int'l LAW. 649 (Fall 1991). Claims can still be submitted to the Federal Ministry of Justice, Heinemannstrasse 6, 5300 Bonn 2, Germany.
kinds of claims for restitution can still be filed. A late submitted claim has the same effect as a timely claim so long as the property at issue has not been sold or otherwise disposed of. If several parties submit claims for the same property, the former owner first victimized by a wrongful expropriation or nationalization recognized under the Property Law is deemed to be the rightful claimant. Once properly submitted, outstanding claims may be legally assigned to third parties.

Once a claim is filed, the affected property is safeguarded by certain statutory restraints on alienation until the claim has been resolved. Before disposing of property, any person with the right to dispose thereof must insure that no claim for restitution has yet to be filed. A timely submitted claim legally obligates any person with the right to dispose of the affected property to refrain from entering into any legal transactions or long-term contractual obligations without the former owner’s notarized written consent. If the current title holder disposes of the property without the former owner’s consent, however, the restitution claim continues to remain valid. In such cases, even a bona fide purchaser must return title to the property. Nevertheless, if the applicable filing deadline was missed or no late filing has occurred, the current owner (i.e., current holder of the property) or any person with the right to dispose of the property may dispose of the property or engage in financial or legal transactions related thereto.

Outstanding claims submitted by former owners are freely assignable, attachable or mortgageable. A former owner of a business may not, however, submit several claims corresponding to the individual as-

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214 Property Law, § 3(4).
215 Id.
216 Id. § 3(2).
217 Id. § 3(1).
218 Id. § 3(5).
219 Id. § 3(3). See also Hinrich Thime & Volkmar Jesch, Real Estate: Restitution and Investment in the New German Länder, INT’L CORP. L., June 1991, at 13, 15. A former owner who learns that the current owner is acting in contravention of such obligations may resort to the German courts in order to receive interim legal protection, such as the recording of a notice in the registry of deeds or the granting of an injunction. Property Law, § 3(3).

Real property is further protected by the requirement that applicable authorities not grant a license necessary for the transfer of real property ownership if either the particular ownership rights are unclarified or the former owner, if any, does not consent to the conveyance. Registration Ordinance, § 6(1); Verordnung über den Verkehr mit Grundstücken, GBl.DDR I, at 73, § 2(2) (Dec. 15, 1977), as last amended by PrHBG, art. 3. If the real property transaction was concluded after October 18, 1989, the validity of the license was capable of being challenged in order to protect a former owner’s rights in the underlying real property by means of an application filed by October 13, 1990. Registration Ordinance, § 7(1).
220 Id.
221 Property Law, § 3(4).
222 Id.
sets of a particular business (i.e., a claim for a business can only be submitted for the entire former business interest), which effectively prevents a former owner from separating the individual assets of a business through the restitution claim procedure in order to make them more readily assignable.\textsuperscript{223}

A thriving secondary market for restitution claims has emerged in Germany. Real estate agents and brokers have been successful in convincing many former owners to assign them their restitution claims at a price often far below the fair market price, although in doing so, such former owners avoided the specter of protracted negotiations or legal proceedings.\textsuperscript{224} As an indication of the magnitude of this secondary market, as of November 1991, it was estimated that roughly a third of all restitution claims for the federal state of Berlin had been assigned by former owners.\textsuperscript{225}

A claimant not interested in receiving restitution may also file to receive compensation, even if he would otherwise be entitled to restitution.\textsuperscript{226} As long as a decision with respect to restitution is pending, a claimant may elect to receive compensation in lieu of restitution.\textsuperscript{227} A decision becomes final within one month of its issuance, unless a written objection has been filed with a review board.\textsuperscript{228} A party adversely affected by a decision of the review board may seek judicial review in a competent court of law.\textsuperscript{229}

While the task of privatization primarily lies with the Treuhand, the job of reviewing restitutionary claims and determining levels of compensation, if any, lies with the so-called Federal Agency for Unsettled Property Issues ("Amt zur Regelung offener Vermögensfragen") [hereinafter Claims Agency] which is assisted by the local authorities. This structure makes it inherently difficult for investors and the Treuhand to determine whether an outstanding restitutionary claim exists with respect to one of the companies held by the Treuhand.

In addition, approximately 1.1 million applications comprising over two million claims for restitution of real property have been filed covering roughly 50\% of all real property in the new federal states, and an

\textsuperscript{223}Property Law, § 3(1).

\textsuperscript{224}Heckel, Ostdeutschland: Schleppende Immobilienrückgabe, WW, Nov. 8, 1991, 30, 31.

\textsuperscript{225}Id.

\textsuperscript{226}Id. § 8.

\textsuperscript{227}Id. § 32(2). This option is not available, however, to former owners whose land was nationalized due to relinquishment of assets, donation, or renunciation of inheritance. Id. §§ 32(2), 8(1), 9(1).

\textsuperscript{228}Id. §§ 33(5), 36(1).

\textsuperscript{229}Id. § 37.
additional 30,500 claims were filed for the restitution of businesses.\textsuperscript{230} The enormous number of outstanding claims and the lack of reliable property records\textsuperscript{231} and qualified administrators has made it difficult to quickly process such claims.\textsuperscript{232} As of October 1991, only 67,000 claims had been fully processed, which represents a mere 3.3\% of all claims filed.\textsuperscript{233} Processing will take much longer than initially expected,\textsuperscript{234} and the president of the Claims Agency, Horst-Dieter Kittke, estimates that processing all claims will take well over ten years.\textsuperscript{235} Approximately 90\% of the claims which have been fully processed to date with respect to businesses held by the Treuhand have not reached the final decision stage.\textsuperscript{236} The main reason for this delay is the fact that the Treuhand has sought legal recourse in almost all cases where the Claims Agency has granted restitution to former owners, since the Treuhand is obligated in such circumstances to compensate the former owner by the amount of the affected business’s decreased value since its transformation from state ownership in 1990.\textsuperscript{237} Initial estimates of this differential value were around DM 1 billion, but more recent estimates have soared to DM 8.5 billion.\textsuperscript{238}

(iii). Remedies Available to Former Owners

If an exclusion exists, the former owner will either receive monetary or in-kind compensation. With respect to real property which is excluded from restitution, the former owner is entitled either to receive the proceeds of the sale from the seller or, in some circumstances, has the right to receive substitute real property of comparable worth.\textsuperscript{239} If the proceeds of the sale of a business or real property are far below such property’s fair market value, however, the former owner may demand to be paid the fair market value from the seller.\textsuperscript{240} Disputes over the actual

\textsuperscript{230} Zwei Millionen Rückübertragungsansprüche im Osten, (Jan., 1992); TREN竽AND, BUYING COMPAINES, supra note 6, at 21.

\textsuperscript{231} For a discussion of the problems and developments with regard to property records in the new federal states, see Böhringer, Die Privatisierungsreform im Osten aus Grundbuchrechtlicher Sicht, 1991 BB 1 (Supp. 13, May 30, 1991); Paus, Grundbuchbeeintragung der Kapitalgesellschaften umgewandelten Wirtschaftseinheiten als Grundstückseigentümer, 1991 NEUE JUSTIZ 262.

\textsuperscript{232} Zwei Millionen Rückübertragungsansprüche im Osten, supra note 230.

\textsuperscript{233} Id. The apportionment of the claims among the various local Claims Agency offices varies greatly. Whereas some offices may have a few hundred claims to process, other offices, such as in Leipzig and Dresden, have over 40,000 claims to process. Id.

\textsuperscript{234} 10,000 Firmen zu verkaufen: So knacken Sie die Treuhand, supra note 92, at 12.

\textsuperscript{235} Zwei Millionen Rückübertragungsansprüche im Osten, supra note 230.

\textsuperscript{236} Id.

\textsuperscript{237} Id.

\textsuperscript{238} Id.

\textsuperscript{239} See Property Law, § 9(2); Special Investment Law, infra note 275, § 3(1).

\textsuperscript{240} Property Law, §§ 3(7), 3a(5); Special Investment Law, infra 275, § 3(1).
market value of the affected real property are to be decided by a competent court of law.241 Similarly, if a property claim was never filed or filed too late, the former owner is generally entitled to the proceeds of the sale.242 The investor is in no way responsible for paying compensation to such former owner and is generally no longer subject to subsequent legal claims for restitution.

If a former owner who has submitted a claim forgoes his right to restitution in exchange for monetary compensation, a compensation fund is to be established in order to provide such compensation.243 It still remains unclear, however, what resources will flow into this fund and to what extent and under what conditions former owners will participate in this fund.244 A draft proposal of the Compensation Law was circulated by the Federal Finance Ministry in November 1991.245 Under the draft proposal, the former owners receiving compensation would be placed in the position they would have been in had they received fair and adequate compensation at the actual point in time of the wrongful taking.246 Such individuals should not receive more compensation than others who previously received "legally adequate" compensation upon expropriation or nationalization and who therefore are not now entitled to additional compensation.247 The draft proposal would establish payment amounts by using April 1, 1956 (when semi-public companies were first established), as the relative point of reference in calculating valuations.248 In determining compensation amounts, net asset values would be taken into account by deducting the liabilities outstanding at the time of the taking. Furthermore, the draft proposes a controversial degressive compensation scale whereby, all things being equal, wealthier individuals would receive less compensation and poorer individuals more.249

In upholding the constitutionality of the blanket exclusion from restitution for expropriations during the Soviet occupation, the Federal Constitutional Court held that some form of compensation would have to be conferred to those affected, although the government was accorded more flexibility with respect to these claims than to other compensation claims.250 Under the draft proposal, those individuals victimized by wrongful takings during the Soviet occupation would also be entitled to

241 Property Law, § 37; Special Investment Law, infra 275, § 5(1).
242 Property Law, § 3(4).
243 Id. § 29a. See also Bonn plant Pauschalzahlungen für DDR-Enteignungen (Nov. 21, 1991).
244 See Bonn plant Pauschalzahlungen für DDR-Enteignungen, supra note 243.
245 See id.
246 See id.
247 See id.
248 See id.
249 Id.
250 Constitutional Court Case, supra note 208, at 12. See also Bonn plant Pauschalzahlungen für DDR-Enteignungen, supra note 243.
the same compensation as others.\textsuperscript{251}

A former owner of a business who has submitted a restitution claim may be reinstated as a manager of such business in order to permit the former owner to assume managerial responsibility of business operations before the business is actually legally transferred to him.\textsuperscript{252} Where a former owner can only provide \textit{prima facie} evidence of his claim, provisional reinstatement will occur only if: (i) there is no reason to believe that the former owner will not manage the business properly; and (ii) the former owner can provide a promising business plan for a company in need of rehabilitation.\textsuperscript{253}

(iv). Available Exclusions and Exemptions

(a). Property Automatically Excluded Under the Property Law

The general exclusion from restitution found in the Unification Treaty with respect to "pressing investment projects" is somewhat more clearly delineated in the Property Law so as to bar restitution where: (i) the nature of the asset in question makes restitution impossible;\textsuperscript{254} (ii) individuals, religious organizations, or nonprofit foundations have acquired ownership or usufructuary rights in assets in good faith;\textsuperscript{255} (iii) real property or a building underwent a significant transformation with regard to its purpose or use prior to September 29, 1990, and the current use of the property serves the public interest;\textsuperscript{256} (iv) real property or buildings which prior to September 29, 1990, were either dedicated to use by the general public, integrated into a housing development project, or incorporated into a business and cannot be returned without considerable impairment to the business;\textsuperscript{257} (v) a current business is no longer comparable with the same business at the time of expropriation due to technical progress and general economic developments;\textsuperscript{258} or (vi) a business has

\textsuperscript{251} See Bonn plant Pauschalzahlungen für DDR-Enteignungen, supra note 243.

\textsuperscript{252} Property Law, § 6a(1).

\textsuperscript{253} Id.

\textsuperscript{254} Id. § 4(1).

\textsuperscript{255} Id. § 4(2). Real property or a building acquired in good faith after October 18, 1989, not covered under this exclusion. Id. An acquisition is defined as not in "good faith": (i) where the acquisition transaction did not comply with the general laws, procedures or other administrative practices of East Germany in force at the time of the acquisition, and the acquirer knew or should have known thereof; (ii) where the acquirer manipulated the date of acquisition, the conditions of acquisition, or his ability to select the object of acquisition by means of corruption or misuse of political influence; or (iii) where the acquirer or a third party instigated by the acquirer induced the former owner to sell or otherwise encumber his property by use of deception or an emergency situation. Id. § 4(3).

\textsuperscript{256} Id. § 5(a).

\textsuperscript{257} Id. §§ 5(b)-(c).

\textsuperscript{258} Id. § 6(1). The business shall be deemed comparable with the expropriated business if the goods or services offered by the business, after considering its technical and economic progress,
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ceased its business operations and such business is unlikely to resume business operations.\(^{259}\)

Due to their inherent ambiguities, however, the above exclusions proved to be grossly inadequate in promoting increased investment. Nevertheless, in order to help quicken the pace of privatization, a number of more concrete exclusions for qualified investors with respect to outstanding restitutionary claims were introduced, and these should help to alleviate much of the previous legal uncertainty regarding property rights in the new federal states.

(b). Property Held by the Treuhand or Local Authorities

After many months of legislative debate, the German federal government revised the Property Law in March 1991 to help clear up property ownership issues by offering investors clear title to property held by the Treuhand or local authorities without exposure to claims for restitution.\(^{260}\) Under this legislation, the Treuhand and the federal, state and local authorities may sell, lease or rent land, buildings or businesses up to December 31, 1992, even if a property claim submitted by a former owner is outstanding, where certain preconditions are met by the investor.\(^{261}\) In other words, investments shall take precedence over restitution claims if certain preconditions are met, but rightful former owners remain entitled to compensation. With respect to investors wishing to purchase, rent or lease land or buildings, such investors must agree

\(^{259}\) Property Law, § 4(1).
\(^{260}\) PrHBG, art. 1, 4. The applicable authorities formally do so by granting a "prioritized investment authorization" ("Investitionsvorrangentscheidung"). Property Law, § 3a(8). See also TREUHAND, INVESTING IN EASTERN GERMANY, supra note 2, at 18.
\(^{261}\) Property Law, §§ 3a(1), (9). See also Scheifele, Zur Anwendung des § 3a Vermögensgesetz durch die Treuhand, 1991 BB 1350; Leo, § 3a Vermögensgesetz — Verfahren für Investitionen?, 1991 DB 1505; Liebs & Preu, Probleme der Rückgabe enteigneter Unternehmen in der früheren DDR, 1991 DB 145. With respect to real property, the Treuhand or the local authorities holding the affected property may decide independently whether a proposed investment meets the legally prescribed criteria without having to obtain approval or an investment certificate as normally would be the case with regard to the exclusion available for privately-held real property which is discussed in subsection (c) below.
either to safeguard old or create new jobs, to erect new housing in areas of housing shortage, or to undertake the infrastructural measures needed in achieving their stated business objectives.\textsuperscript{262} With respect to investors wishing to acquire or lease a business, such investors must show that their business objectives will either safeguard old or create new jobs or improve the competitiveness of such business, or if a restitutionary claim is outstanding, the holder of such claim cannot provide a guarantee for the continued existence of the business.\textsuperscript{263} Nevertheless, the exclusion will be invalid if: (i) before a legally effective sales, lease or rental contract has been concluded between the applicable authorities and the investor, the Claims Agency decides that the affected property should be returned to the former owner; or (ii) if the former owner has been allowed to participate in the management of the affected business, if any.\textsuperscript{264}

This right of immediate alienation permits the governmental authorities to sell, lease or rent property subject to outstanding property claims without having to go through the time consuming process of receiving the approval from a government body or legal court. Nevertheless, where possible, the Treuhand is obligated to notify former owners of its intention to sell their former business and to give such former owners an opportunity to formulate a competing bid.\textsuperscript{265} The primary considerations in determining whether interested investors or former owners should be granted possessory rights to disputed property are: (i) the group which is willing and in a position to make the necessary investment; and (ii) the investor or the former owner who is prepared to make such an investment and has the more promising business concept.\textsuperscript{266} A former owner who is passed over in favor of investors will nevertheless receive compensation for his claim from the appropriate government authority.\textsuperscript{267} This exclusion is only effective if the underlying contractual agreement contains a provision to the effect that if the guarantees or obligations of an investor are not upheld during the first two years, the former owner is entitled to reclaim his property.\textsuperscript{268}

To date, investors have made limited use of this exclusion.\textsuperscript{269} The Treuhand has instead wished to have the former owner and an interested investor negotiate a mutually agreeable settlement on their own concern-

\begin{itemize}
\item \textsuperscript{262} Property Law, § 3a(1)(1).
\item \textsuperscript{263} Id. § 3a(1)(2).
\item \textsuperscript{264} Id. § 3a(2).
\item \textsuperscript{265} Id. §§ 3a(3), 3(7).
\item \textsuperscript{266} Id. § 3(7).
\item \textsuperscript{267} Id.
\item \textsuperscript{268} Id. § 3a(7).
\item \textsuperscript{269} As of December 1991, the Treuhand had processed two-thirds of the 288 requests it had received and had only granted 73 exclusions. \textit{Ost-Investoren werden Steine in den Weg gelegt}, Süddeutsche Zeitung, Dec. 12, 1991, at 37, col. 4.
\end{itemize}
ing the investor's acquisition of the underlying property outside of the cumbersome governmental apparatus.\textsuperscript{270} As mentioned earlier, many former owners have assigned their claims to real estate agents and brokers who are likely to be more sophisticated in negotiations with investors.\textsuperscript{271} Those who initiate negotiations to acquire a restitution claim from a former owner or assignee should realize that they run the risk of acquiring an illegitimate claim and may end up paying twice to acquire property (i.e., paying both the legitimate and illegitimate owner).\textsuperscript{272} This contingency can be drafted around in the underlying assignment agreement, however, by specifying that the investor may rescind the transaction in the event another restitution claim becomes legally effective with regard to the affected property.

The number of cases in which the former owner and an investor have reached settlement has been noticeably increasing, and former owners and investors are also being actively encouraged by authorities other than the Treuhand to seek an amenable settlement.\textsuperscript{273} Nevertheless, although only a small percentage of former owners who have filed restitution claims actually intend to reacquire their former property, many are waiting for the passage of impending legislation with detailed provisions concerning compensation in lieu of restitution (so-called "Compensation Law") in order to determine whether opting for compensation or restitution is in their best financial interest.\textsuperscript{274}

(c). Privately-Held Real Property

This exclusion offers clear title to sell or lease \textit{real property} not held by the Treuhand or local authorities without exposure to claims for restitution.\textsuperscript{275} In summary, investors are given priority over those seeking restitution for the period up to December 31, 1993, if they receive an investment certificate from the municipal authorities.\textsuperscript{276} In order to receive such an investment certificate, investors must meet the same pre-

\textsuperscript{270} Zwei Millionen Rückübertragungsansprüche im Osten, supra note 230. See also Property Law, § 6a(4).

\textsuperscript{271} See Auch nach Vertragsabschluss stören unklare Eigentumsverhältnisse, FRANKFURTER ALLGEMEINE ZEITUNG, Nov. 26, 1991, at 17, col. 4.

\textsuperscript{272} See Heckel, supra note 224, at 31.

\textsuperscript{273} Under § 3(5) of the Property Law, the authorities are required to promote such a solution.

\textsuperscript{274} See Bonn plant Pauschalzahlungen für DDR-Enteignungen, supra note 243; Zwei Millionen Rückübertragungsansprüche im Osten, supra note 230.


\textsuperscript{276} Special Investment Law, §§ 2(1)-(2). For property not disposed of by the beginning of 1993, however, rightful claimants will once again have a right to restitution.
conditions for land and buildings which apply pursuant to the exemption described in subsection (b) directly above.\textsuperscript{277} Outstanding ownership claims to such property will be limited to financial compensation.\textsuperscript{278} Prior to a final decision on an investment certificate, a public hearing must be held at which both the former owner and the public at large have a right to be heard.\textsuperscript{279} In addition, the former owner or his assignees have the same rights to match an outstanding investment offer as with regard to property held by the Treuhand or the local authorities.\textsuperscript{280} In order to prevent abuse of this exemption, a reversion clause must be included in the underlying real estate contract to the effect that the property shall revert to the excluded former owner if the stated business plan is not followed.\textsuperscript{281}

(v). Recommendations

It is highly unlikely that investors will be held responsible for paying compensation to former owners pursuant to the much awaited compensation law. Also, investors benefitting from a restitution exclusion are generally no longer subject to subsequent legal claims for restitution. However, investors should nevertheless as a preventative measure clarify their liability in negotiations with the Treuhand with respect to the the amount, if any, by which the overall compensation to be received by the former owner exceeds the actual purchase price and have the Treuhand expressly assume the payment obligation for this difference.

In addition, unless property ownership issues are completely settled and clear title can be passed, any purchase agreement should include a provision allowing the investor an option to rescind the transaction in the event another outstanding restitution claim becomes legally effective with respect to the affected property. In the alternative, a provision should be included in the purchase agreement to the effect that if, contrary to the expectations of the contracting parties, the former owner or a third party is granted a right to reconveyance of the property, for whatever reason, the parties may modify the agreement in accordance with the changed circumstances and particularly with respect to the purchase price. Although the Treuhand is more likely to agree to the latter provision, such a provision may not adequately protect an investor's interests, because the Treuhand typically excludes itself from any obligation to pay contractual damages.\textsuperscript{282}

\textsuperscript{277} Id. § 1(2).
\textsuperscript{278} Id. § 3(1).
\textsuperscript{279} Id. § 4.
\textsuperscript{280} Property Law, § 3(7).
\textsuperscript{281} Special Investment Law, §§ 1(3), 1d.
\textsuperscript{282} See Thime & Jesch, supra note 219, at 16.
Furthermore, if property is later reconveyed to a former owner or a third party, the purchaser should seek to receive complete or partial reimbursement for investments made or expenses incurred in connection with the acquired property where the business purpose of the purchase transaction disappears upon reconveyance of such property.

b. Real Property Valuation

Upon transformation, the newly-formed companies acquired legal title to the assets at the disposal of their predecessors. As a result, transformed companies were required to create opening financial statements in order to facilitate asset valuation and bring accounting procedures into line with those followed in West Germany. In view of the complexity of valuing assets in an economy without an efficient free market, the Treuhand had, until recently, assumed that any real property appraisal could only be provisional. In order to prevent speculation with real property, the Treuhand usually built into a purchase agreement the requirement that real property be reappraised at a later date. Any difference in the value of such property between the date of purchase and the date of reappraisal would then be paid to the Treuhand by the investor. The main office of the Treuhand has stated that investors acquire...

283 Treuhand Law, § 11(2).
284 Gesetz über die Eröffnungsbilanz in Deutscher Mark und die Kapitalneufestsetzung (D-Markbilanzgesetz), BGBl. II, at 1169, § 1 (Aug. 31, 1990) [hereinafter DM Accounting Act], published in Unification Treaty, supra note 1, appen. II, chap. III(D). In effectuating the monetary and economic union between the two Germanies, an alignment of their financial accounting systems became necessary. To this end, the DM Accounting Act, which became effective concurrently with the Unification Treaty on October 3, 1990, established an accounting framework which companies in the new federal states were to follow in formulating an opening balance statement for the business year beginning July 1, 1990. An opening balance sheet had to be drawn up by all business entities in the new federal states which are obligated to keep books pursuant to Section 238 of the West German Commercial Code and to comply with the general accounting and valuation principles found in the Commercial Code unless specified otherwise. Id. Such opening balance sheets must have been reviewed or audited by a certified public accountant ("Wirtschaftsprüfer"). The DM Accounting Act must also be adhered to for tax accounting purposes. Id. § 50.


285 Id.
286 Id.
287 Id.
ing real property from the Treuhand will no longer be required to accept a reappraisal clause. Nevertheless, given the decentralized structure of the Treuhand and the fact that each branch office has developed its own set of standard contracts, reappraisal provisions in practice may often still be found in such contracts.

In order to avoid this result, negotiations with the Treuhand should seek either to: (i) completely avoid a reappraisal provision altogether; (ii) achieve an agreement that reappraisal only take place where the purchaser sells such real property within a certain time period (usually after less than five years) without having a valid business purpose for doing so; or (iii) have reappraisal take place as soon as possible after acquisition, and have the Treuhand agree to assume a portion of any appreciation in value below a predetermined maximum limit and all appreciation above such ceiling. In addition, investors should make sure that any reappraisal provision concerning real property solely pertain to land and not to buildings or other structures.

c. Employment Laws, Dismissals and Job Guarantees

Potential investors should keep in mind that German labor laws are among the strictest in Europe. German law does not contain a comprehensive labor code, and the employment law is dispersed throughout a number of different codes, regulations, and court decisions. The labor laws and social system of West Germany were generally adopted in the new federal states pursuant to the Unification Treaty. Nevertheless, some elements of the former East German employment law and social system will remain in effect and will be phased out over time. As a

\[\text{288 See BDI, ENTREPRENEURSHIP, supra, note 33, at 3.}\]
\[\text{289 Scheifele II, supra note 171, at 630. The Treuhand has been willing in the past to agree to have reappraisal take place as soon as two years after acquisition. Id.}\]
\[\text{290 Id.}\]
\[\text{291 Article 30(1) of the Unification Treaty, supra note 1, calls for the promulgation of a uniform labor code for united Germany, but such an undertaking should take quite some time to complete.}\]
\[\text{292 These include among others: (i) the Basic Law which guarantees the right to work, equality of employment opportunity, and the right to establish unions; (ii) the Civil Code ("Bürgerliches Gesetzbuch") which addresses all types of employment relationships; (iii) the Commercial Code ("Handelsgesetzbuch") which regulates the legal relationship between commercial employers and employees; (iv) the Industrial Code ("Gewerbeordnung") which sets forth labor safety guidelines and regulates the legal relationship between industrial employees and employers; (v) the Works Council Constitution Act ("Betriebsverfassungsgesetz") and the Codetermination Law ("Mitbestimmungsgesetz") which address worker participation in major management decisions.}\]
\[\text{294 Unification Treaty, supra note 1, appen. I, chap. VIII. For a good overview of the labor and social law currently applicable in the new federal states, see W. WALKER, ARBEITSRECHT IN}\]
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rule, West German labor laws are applicable to employment relationships in the new federal states created on or after October 3, 1990. Many of the companies in the new federal states remain overstaffed and will need to reduce their work forces in order to become competitive. The dismissal of employees in Germany, however, is typically much more cumbersome and expensive than in the United States. 295

(i). Codetermination and the Social Plan

One reason for the difficulty and expense of dismissing employees is the legal principle of codetermination ("Mitbestimmung") which mandates the participation of employees at all levels in corporate governance through the establishment of a works council ("Betriebsrat") and through representation on a company's supervisory board. In businesses with five or more employees, the employees may establish a works council which solely represents employee interests, ensures compliance with employment laws, and participates in major company decisions concerning working conditions, production, personnel, and vocational training. 296 Any dismissal of an employee without prior consultation with the works council is legally invalid. 297 The works council may only disapprove a proposed employee dismissal based on the following grounds: (i) the employer did not sufficiently consider the social implications of the dismissal on the proposed employee; 298 (ii) the employer did not properly follow the applicable dismissal selection guidelines; 299 or (iii) there is a

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295 Indirect wage expenses, such as social security benefits, are now also quite high in the new federal states. The German social security system encompasses pension and unemployment insurance (typically approx. 24% of gross salary), health insurance (approx. 12%), and workmen's compensation insurance (between approx. 1% to 11% depending on a job's degree of risk). Contributions are paid in equal amounts by employees and employers, with the exception of workmen's compensation insurance payments which are paid entirely by the employer. KPMG, INVESTMENT IN GERMANY 57-60 (1990); IL&T, supra note 9, at 23.

296 IL&T, supra note 9, at 21.

297 Betriebsverfassungsgesetz [BetrVG], § 102(2)(1).

298 In making dismissal decisions, the employer must dismiss those employees who are effectively less disadvantaged by such dismissal. Thus, given equal qualifications and performance among employees, a termination will be invalid if factors such as age, years of company service, marital status, number of children, etc., are not taken into account. Kiindigungsschutzgesetz [KSchG], § 1(3). The Kiindigungsschutzgesetz does not apply to a business with less than six employees, and part-time workers are only counted in determining the total number of employees if they work more than 10 hours per week or 45 hours per month. Id. § 23(1). In addition, the Kiindigungsschutzgesetz does not apply to someone who has been employed for less than six months. Id. § 1(1).

299 See BetrVG § 95.
possibility that the affected employee can remain in the employment of the particular business but assume a different position after retraining, or that the employee remain but agree to less favorable contractual terms.\textsuperscript{300}

In addition, all limited liability companies with more than 500 employees must generally form a supervisory board, and the employees are entitled to elect one third of the members of the supervisory board.\textsuperscript{301} All public stock corporations with at least one employee must undertake the same.\textsuperscript{302} In all companies with more than 2,000 employees, however, the employees elect one half of the supervisory board members.\textsuperscript{303}

A social plan ("Sozialplan") setting forth the compensation to be paid to dismissed employees, as well as any additional measures to aid such employees in overcoming economic or financial diversity, must generally be formulated by a company for the contingency of future dismissals.\textsuperscript{304} Establishment of a social plan is required where a business dismisses: (i) more than 20\% of their regular workforce but at least 6 employees in a company with 20 to 60 employees; (ii) more than 20\% but at least 37 employees in a company with 60 to 250 employees; (iii) more than 15\% but at least 60 employees in a company with 250 to 500 employees; or (iv) more than 10\% but at least 60 employees in a company with more than 500.\textsuperscript{305} Companies in their first four years of existence are generally excepted from this requirement, although this exception does not apply to a restructuring or reorganization where the underlying business existed for more than four years.\textsuperscript{306} It is yet unclear, however, whether this exception generally applies to companies acquired from the Treuhand which were transformed from state-ownership if they previously existed as a business for more than four years.\textsuperscript{307}

\textsuperscript{300} Id. § 102(3). It is uncertain whether the general Western German obligation of an employer to first explore other means other than dismissals (e.g., part-time work, retraining, or transfer to different department) to obtain the same business objective also is applicable in the new federal states. See RWS-Dokumentation 6, supra note 294, at 25-26. For more information regarding the works council, see Walker, supra note 294, at 106.

\textsuperscript{301} BetrVG § 77.

\textsuperscript{302} Id. § 76.

\textsuperscript{303} Mitbestimmungsgesetz [MitbestG], § 1.

\textsuperscript{304} BetrVG § 112(2). The Treuhand has published comprehensive guidelines to be followed in establishing a social plan for one of its companies. Treuhandanstalt, Richtlinie zu Socialplänen (1991). See also Hinweise zur Sozialrichtlinie, 1991 Treuhandinfo 10.

\textsuperscript{305} BetrVG § 112a(1).

\textsuperscript{306} Id. § 112a(2).

\textsuperscript{307} The Federal Labor Court held in June 1989 that a newly-formed company in the first four years of its existence which undertakes a reorganization or restructuring is also freed from the social plan requirement where the company acquires a going concern which has existed longer than four years. Bundesarbeitsgericht, I ABR 14/88 (June 13, 1989), reprinted in 1989 DB 2335. It is disputed among commentators whether the companies transformed from state-ownership should be considered companies with an existence prior to the date of their transformation or newly-formed
(ii). Dismissal of Employees

The German employment scheme distinguishes between wage earners ("Arbeiter"), salaried employees ("Angestellte"), and executives ("leitende Angestellte"). The generally required notice period to dismiss an Eastern German employee is six weeks for salaried employees and two weeks for wage earners, and these periods are extended after more than five years of continuous employment. Even though the same length of notice applicable to Western German wage earners has been held to be an unconstitutional restriction of a worker's rights and new legislation addressing this issue must be promulgated before June 30, 1993, the same notice periods for Eastern German workers were nevertheless left unchanged by the Unification Treaty.

Under Section 613a of the German Civil Code, investors acquiring a German business must generally assume the existing employment obligations of such business, including collective bargaining agreements, other similar agreements, and outstanding salary claims. No employment dismissals may occur as a result of the acquisition itself. An exception to this general rule exists, however, where one or more dismissals are justified by compelling business reasons or due to an employee's unsatisfactory performance or personal conduct. "Compelling business reasons" has been interpreted in the German case law to mean steps which must be taken in pursuing a general business strategy, which an employer is free to decide. Nevertheless, if a dismissed employee initiates litigation, the employer must substantiate his underlying business decision with hard facts, and the employer typically has a rather high standard of proof in doing so. Thus, in the case of dismissals based on compelling business reasons, although severance pay is not legally required, it may be in the interest of an investor to make a dismissed employee generous companies effectively acquiring a going concern. See Hanau, supra note 37, at 106-107; RWS-DOKUMENTATION 6, supra note 294, at 22-23; Scheifele II, supra note 171, at 634, n.50.

308 See BGB § 622. Dismissal of executives revolves around individually negotiated employment contracts, which typically call for one year's severance pay, although longer periods are not uncommon. See also IL&T, supra note 9, at 24.

309 Arbeitsgesetzbuch der DDR [AGB-DDR], § 55. See also WALKER, supra note 294, at 104-105.


311 Unification Treaty, supra note 1, appen. I, chap. III, § B(2). See also WALKER, supra note 294, at 104.

312 BGB § 613a(1)(1). See generally Willemsen, Der Grundtatbestand des Betriebsübergangs nach Absatz 613a BGB, 1991 RDA 204.

313 Id. § 613a(4).

314 KSchG § 1.

315 Id.

316 See Bundesarbeitsgericht, Arbeitsrechtliche Praxis, Nos. 6, 8, to KSchG § 1 (1969) (Betriebsbedingte Kündigung).
severance payments in order to avoid potentially costly litigation. The rule of thumb in Western Germany in determining severance payments is typically one gross monthly salary for each year of employment, and the Treuhand has established a rough rule of thumb for its companies of a one-fourth monthly salary for each year of employment. In addition, rather than dismissing employees, employers should consider allowing them to work on a part-time basis and government funds may be available in helping to compensate such part-time employees.

A company which unjustifiably dismisses employees runs the risk of facing a lawsuit. Such a termination dispute can often take many months to be decided, and a losing employer must typically make severance payments to such employees which may amount to as much as twelve gross monthly salaries per employee.

(iii). Mass Dismissals

If a company plans to undertake a “mass dismissal,” the management must discuss its plans with the company's works council before sending out termination notices. In so doing, the employer and the works council must formulate a mutually agreeable social plan. If no agreement is reached, a conciliation board containing representatives from each side and an independent chairman is to be formed to resolve the matter. If all other preconditions are met, a mass dismissal may be implemented before the conciliation board reaches a decision. The compensation payments granted to dismissed employees in a social plan typically correspond to normally conferred severance payments.

(iv). Dismissal of Unionized Employees

For companies sold by the Treuhand, regardless of whether compel-
ling business reasons exist or whether a mass dismissal is planned, the amount of severance pay to be received by each dismissed unionized employee has been agreed upon by the Treuhand, the Federation of German Trade Unions, and the Union of German Salaried Employees. Under this agreement, severance pay for each employee amounting to four months gross salary is sufficient if such amount can be paid out without assistance from the Treuhand. If this is not the case and a company is not in a position to fully meet its severance pay obligations, the Treuhand has generally agreed to provide funding to the company for this purpose up to a maximum average sum of DM 5,000 per effected employee. The apportionment and distribution of this lump sum amount received from the Treuhand is the sole responsibility of the company, and the company is obligated to make its apportionment decision by taking into consideration the relative social needs of each dismissed employee.

(v). Bankruptcy Exception

If an investor acquires a company or assets of a company while such company is in the midst of bankruptcy proceedings, an exemption from the requirements of section 613a of the Civil Code has been provided for up until December 31, 1992. In such event, all employees of a company or connected with acquired company assets are not assumed as a result of their acquisition and thus need not be retained.

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327 Gemeinsame Erklärung von Deutschem Gesellschaftsbund, Deutscher Angestellten-Gewerkschaft und der Treuhand (Apr. 13, 1991) [hereinafter Joint Union Declaration], reproduced in TREUHAND AZG, supra note 77, at 14. See also Hinweise zur Sozialplanrichtlinie, 1991 TREUHANDINFO 10. Unions in Germany have a strong influence over all aspects of employment. Although German unions exercise sizeable political and economic influence, they typically do not act aggressively, but work cooperatively and are reasonable in their demands. See IL&T, supra note 9, at 21.

328 Joint Union Declaration, supra note 327, Item 2. This amount is reduced to a maximum of DM 3,000 for employees enrolled in government-sponsored work or retraining programs within one year following termination, and a maximum of DM 2,000 for employees who may retire within one year following dismissal. Id.

329 Id. Hinweise zur Vereinbarung über Sozialpläne, Item 4. In making such a decision, a company should consider each dismissed employee’s length of employment, age, income, number of dependents, and the overall social benefits to which individual employees are entitled, including interim retirement benefits, pension benefits, and government-sponsored work and retraining programs. Id.

330 SpTrUG § 16(2). See also RWS-DOKUMENTATION 6, supra note 294, at 24-25. The federal government originally had planned to generally exclude the application of BGB Section 613a to the new federal states. This general exclusion, however, would have required the consent of the European Community given its Regulation 77/187. EC Treaty, art. 189(3). Nevertheless, such is not the case with respect to companies or assets thereof under bankruptcy. EuGH, ZIP 1985, at 824. See also Schellele II, supra note 171, at 633-34.

331 See RWS-DOKUMENTATION 6, supra note 294, at 24-25.
ructy, or some or all of the assets of such company, would have to assume all of the company's existing employment obligations with the exception of any outstanding salary claims.332

(vi). Recommendations

The Treuhand has been understandably concerned with safeguarding as many jobs as possible in the new federal states, and it expects any prospective purchaser to give a clear indication in its business plan of the number of jobs it plans to maintain and/or create.333 As a result, the number of employees an investor is willing to retain is weighed quite heavily by the Treuhand in comparing competing bids.334 The problem, however, is that most of the companies held by the Treuhand are overstaffed and require layoffs in order to maximize their competitiveness. As described above, investors wishing to lay off several employees are generally responsible for making compensation payments. The company to be acquired typically may establish a reserve in its balance sheet to cover such compensation payments and other additional measures, if any, and such costs may thereby be shifted to the Treuhand, which would most likely result in an increase in the purchase price of the targeted company by the same amount.

As a result, any prospective investor should try to achieve an agreement that the Treuhand dismiss any excess employees prior to the completion of the purchase or that the purchase price be reduced by the overall amount of compensation or severance payments to be made by the investor.335 In addition, the Treuhand often will require a prospective purchaser to guarantee that a certain number of jobs will be maintained, especially where many employees are to be dismissed, and an investor should keep in mind that damages for noncompliance with any job security guarantees could be substantial.336

d. Environmental Cleanup and Liability

(i). Legal Background

The environmental laws that were in place in East Germany prior to unification fell well below Western European and U.S. standards. Worse

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332 See WALKER, supra note 294, at 148-149; Scheifele II, supra note 171, at 633.
333 TREUHAND PRIVATIZATION, supra note 169, at 7.
334 Id.
335 Scheifele II, supra note 171, at 633.
336 Such damages for noncompliance are typically grounded on a breach of the underlying purchase agreement with the Treuhand and are generally based on a percentage of the salary per employee multiplied by the number of employees that are actually dismissed. The Treuhand often requires that a contractual provision be incorporated into purchase agreements which include job or investment guarantees.
yet, however, was the unpleasant fact that these weak environmental laws were only abided by if they were viewed as economically expedient. Although planning for industrial and commercial construction typically included environmental components, such environmental safeguards were not implemented either due to a lack of financial means or a perceived need to boost production at the expense of environmental protection. As a result, the environment in the new federal states, especially in the south, has been abused and/or neglected for decades.

In order to bring the environmental laws in East Germany into line with those in West Germany, the two Germanies agreed to an environmental union ("Umweltunion") on May 18, 1990. As a result of this agreement, East Germany adopted a new Environmental Framework Law ("Umweltrahmengesetz") on June 29, 1990, which generally contained the basic provisions of West German environmental law but also included certain transitional compliance periods. On October 3, 1990, the Unification Treaty called for the adoption of West German environmental legal standards in the new federal states, although certain adjustments were also necessary. Although EC environmental legislation also became applicable in the new federal states as of reunification, the European Community has adopted a number of transitional measures that apply retroactively as of October 3, 1990, in the new federal

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337 Bundesumweltministerium, Ökologischer Aufbau: Eckwerte der ökologischen Sanierung und Entwicklung in den neuen Ländern 12 (Nov. 1991) [hereinafter BMU, ECOLOGICAL DEVELOPMENT].

338 MESU, art. 16.


340 See Unification Treaty, supra note 1, chap. VII, art. 34. Commercial plants and installations which were built or under construction after July 1, 1990, must generally meet the same environmental standards as their Western German counterparts. Id. art. 16. Given the high air pollution levels in some Eastern German regions, some allowances have been made in order to accommodate economic growth. In this respect, authorization by the applicable authorities (in the form of permits) for the construction, renovation or operation of such a commercial plant or installation cannot be withheld if: (i) the additional impact on the environment will be negligible and a sizeable decrease in overall emissions is to be expected within the following five years; or (ii) the new plant or installation is meant to replace or improve the efficiency of an already existing plant and will ultimately result in a decrease in existing emission levels. See Bundes Immissionsschutzgesetz [BImSchG], § 67a(2); Unification Treaty, supra note 1, appen. I, chap. XII(A), § 2(6). Commercial plants or facilities in existence or under construction on or before July 1, 1990 do not initially need to file for permits to continue operations, and Western German standards will be phased-in over time with regard to such plants. BImSchG § 67a(1); Unification Treaty, supra note 1, appen. I, chap. XII(A), § 2(6).
Nevertheless, environmental protection in Eastern Germany is governed primarily by the general police law of the respective federal state which typically empowers the local authorities to take whatever steps are necessary to protect the public safety and environment.

(ii). Extent of Environmental Contamination

Environmental contamination and damage are to be found in the air, water, ground and structures throughout the new federal states. It is estimated that approximately DM 300 billion for environmental cleanup and protection measures will be required over the next ten years to bring the new federal states up to Western German levels. The following data, which represents only the tip of the iceberg, should serve as a good indication of the extent of such contamination: (i) a mere 3% of watercourses and 1% of standing waters are ecologically sound for drinking, and 42% of watercourses and 24% of standing waters are so contaminated that they can no longer be purified for drinking; (ii) former East Germany had the dubious distinction of being the world’s largest per capita energy consumer and 80% of its electricity generation was derived from burning highly polluting brown coal; (iii) 26% of the public in the new federal states lives in areas where smoke particle levels (so-called “suspended particulate levels”) exceed safety levels, and 36% live in areas where sulfur dioxide emissions, due primarily to brown coal burning, exceed safety levels; (iv) of the approximately 11,000 garbage dumps in former East Germany, only one met West German standards before reunification and roughly 10,000 were operated without any safety stan-

341 See EC Unification Bulletin, supra note 7, at 101 (summary table of such transitional measures); Maria J. Ionata, Note, German Unification and European Community Environmental Policy, 14 Brit. Colum. Int’l & Comp. L. Rev. 333 (1991). Transitional measures were only instituted where the state of the Eastern German environment is such that meeting EC standards was unattainable upon unification. Subject to EC standards upon reunification were purely legislative or administrative measures, product standards (with the exception of those covering hazardous substances), and all new plants and projects. As a result, approximately 80% of EC environmental law is currently applicable in the new federal states. Transitional measures do exist, however, particularly with respect to the chemical and pharmaceuticals industries, and to air and water pollution. Id. at 99. See also Scheifele II, supra note 171, at 635. For a general overview of the incorporation of former East Germany into the European Community, see section IV herein.


344 BMU, Ecological Development, supra note 337, at 13. As of late 1990, it was estimated that roughly 58% of the Eastern German population were drinking, constantly or intermittently, contaminated water. Bundesumweltministerium, Wege aus der ökologischen Krise: Bundesumweltminister Töpfer legt Eckwerte der ökologischen Sanierung und Entwicklung in den neuen Ländern vor, Pressemitteilung Nov. 15, 1990, at 2 [hereinafter BUM, Wege aus der ökologischen Krise].

345 Treuhand, Buying Companies, supra note 6, at 17.

346 BMU, Ecological Development, supra note 337, at 15.
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(d) or precautions;347 (v) up to 1990, former East Germany had a total of twenty open air incineration facilities which burned 2,800 tons of garbage in 1989 alone, and an additional 90,000 tons of garbage was burned in incineration facilities without smoke filters;348 and (vi) 27,877 identified plots of land are suspected of being environmentally contaminated, and it is estimated that this is only 60% of the actual amount.349 Although the federal and state governments and the general public appear to be genuinely devoted to greatly improving the environmental situation, the legacy of over forty years of environmental neglect has made an ecological recovery in the new federal states a long and costly process.

Nevertheless, the introduction of a market economy in the new federal states has provided them with a new lease on their environment given the Western German bent toward environmentally sound industrial development. Tougher laws and enforcement measures, raised energy prices, new commercial investment, the introduction of Western advances in pollution prevention, and better maintenance and management, as well as sensible economic development policies, should substantially aid in improving the state of the environment, although cleaning water supplies will require more time and money than other environmental areas.350 In addition, the German government has instituted a new environmental action program as well as a wide range of immediate measures in the new federal states in order to help protect the public safety and welfare.351

(iii) Recommended Initial Steps.

One of the largest impediments to investment in the new federal states has been the well-founded concerns of investors regarding environmental liability and cleanup costs. As can easily be inferred from the environmental data listed above, environmental contamination and damage are extensive in most production facilities and in many businesses in the new federal states. The German government has or plans to under-

347 BUM, Wege aus der ökologischen Krise, supra note 344, at 2.
348 BMU, ECOLOGICAL DEVELOPMENT, supra note 337, at 18-19. Approximately 90% of the installations in Eastern Germany did not meet EC standards upon reunification. EC UNIFICATION BULLETIN, supra note 7, at 98. These are the highest levels in any country in Europe. Id. at 97.
349 BMU, ECOLOGICAL DEVELOPMENT, supra note 337, at 20-22.
351 See BUM, Wege aus der ökologischen Krise, supra note 344, at 5-7. The environmental action program also covers immediate measures ("Sofortmassnahmen") to: (i) create and/or support approximately 200,000 jobs in the area of environmental cleanup; and (ii) to form a sound environmental infrastructure, in particular with respect to environmental cleanup. As of early 1991, the Federal Environmental Ministry had already spent around DM 500 million on over 600 projects for the action program. See generally Bundesumweltministerium, Nationale Solidaritätsaktion ökologischer Aufbau: Arbeitsplatzsicherung durch Umweltsanierung in den fünf neuen Ländern, PRESSEMITTEILUNG, Feb. 19, 1991.
take a number of measures to alleviate the danger to the public but is not obligated past such threshold to assume any liability for environmental cleanup.\textsuperscript{352}

Environmental cleanup costs can potentially be astronomical and far exceed the amount of the purchase price for an acquired company or real property. Neglect of this particular issue in making investment decisions could lead to substantial financial risk for investors. The local authorities are generally authorized either to take all necessary measures to clean up environmental contamination at the expense of the owner of the affected property or to demand such owner to undertake the necessary cleanup measures himself.\textsuperscript{353}

Even though companies held by the Treuhand are required to inform potential investors about the environmental condition of their property, it is nevertheless important for potential investors to uncover all prior uses of the real property and have an environmental assessment done on such property, so that environmental contamination, if any, can be taken into account in negotiations with the Treuhand and in applications with the local authorities for release from environmental liability.

(iv). Releases From the Local Authorities

Purchasers of commercial property in the new federal states may seek release from public and private liability claims for environmental contamination or damage incurred prior to July 1, 1990.\textsuperscript{354} Without the possibility of obtaining such an exemption, the purchaser of commercial

\textsuperscript{352} These measures include: (i) the extension of research and development activities to the specific environmental cleanup techniques and methods currently utilized in the new federal states; (ii) the immediate alleviation of danger to the public arising from contaminated plots; (iii) the assumption of the responsibility for environmental cleanup through the Treuhand (see section II(C)(3)(d)(5) herein); and (iv) making available local investment grants from the “Gemeinschaftsaufgabe zur Verbesserung der regionalen Wirtschaftsstruktur” (see section III(A)(3)(b) herein), insofar as environmental cleanup occurs with respect to industrial or commercial facilities. BUM, Wege aus der ökologischen Krise, supra note 344, at 10-11.

\textsuperscript{353} See Thieme, supra note 342, at 13. The local authorities have discretion to hold the actual polluter, the lessee, if any, and/or the owner jointly and severally liable. Id.

property would be liable for both public and private claims resulting from any environmental damage or pollution discovered on the real property as the owner of such property, even for amounts exceeding the purchase price of an acquired company or real property.\textsuperscript{355} Even though the former owner or actual polluter is ultimately liable under German law, there is no realistic way to make the polluter or former owner of this property liable for pollution cleanup.\textsuperscript{356}

Releases can be requested by each natural person or business entity who owns, acquires or operates property used for commercial purposes or an industrial plant. Applications for releases must be filed before March 29, 1992, with the applicable local authorities.\textsuperscript{357} At the point in time at which a decision is made by the local authorities, the underlying acquisition must be completed before an application can be decided upon.\textsuperscript{358} The applicable local authorities are severely understaffed and it is uncertain how long applicants should expect to wait for a response.

The applicable authorities have discretion to grant a complete, partial or conditional exemption after weighing the overall interests of the effected parties (i.e., investor, general public, environment, those injured, and those at risk) with respect to the proposed acquisition.\textsuperscript{359} Although

\begin{itemize}
\item \textsuperscript{355} Scheifele II, supra note 171, at 635.
\item \textsuperscript{356} Id. Those held liable by the local authorities for environmental pollution generally do not have a right to indemnification from other polluters, lessees or former owners, unless otherwise agreed by contract. See Thieme, supra note 342, at 13.
\item \textsuperscript{357} Environmental Framework Law, art. 1, § 4(3). Such application does not require any particular form but should include information concerning: (i) the property itself; (ii) the underlying title documents and excerpts; (iii) any planned investment projects; (iv) the extent of existing contamination known to the applicant; (v) an evaluation of the risk and the probable cleanup costs; and (vi) a declaration that environmental contamination occurred prior to July 1, 1990. BUM, Release Regulations, § II(5). See also Thieme, supra note 342, at 15.
\item \textsuperscript{358} BUM, Release Regulations, § II(2)(6). All formal legal acts, such as registration of an acquisition in the applicable Registry of Deeds, need not have already taken place before a release decision can be made. Id. Investors are permitted to condition an acquisition upon the receipt of a release, and the local applicable authorities may also condition a release on the full completion of an acquisition. Id.
\item \textsuperscript{359} Environmental Framework Law, art. 1, § 4(3). In making their decision, the applicable authorities must also consider: (i) the respective benefits to the purchaser and the general public; (ii) general economic factors, including labor policy and infrastructure considerations; (iii) overall risk to the general public and other environmental protection considerations; (iv) the magnitude of the cleanup costs; and (v) the liability exposure of the purchaser if a release is not granted. BUM,
releases are, as a general rule, not to be expected, the probability of receiving a release increases if the environmental condition of a specific company's commercial property jeopardizes its chances of survival. If a release is denied, the decision may be contested in the administrative courts. The chances of overturning such a denial are poor, however, given the discretionary nature of the local authority's decision.

Even if an application is made and accepted, however, the current law still contains some inherent problems, and the local authorities have been quite reluctant in granting releases. For instance, investors seeking a release must provide *prima facie* proof that the contamination occurred prior to July 1, 1990, but the ability to provide such proof becomes more difficult as time passes. Thus, the longer potential investors wait to invest, the more difficult it will be for them to provide the proof necessary to receive a release. In addition, it is unclear whether a granted release would also cover subsequent purchasers as successors in right or whether the company itself (as active polluter) remains liable for cleanup costs and other claims even though the majority shareholder is supposedly exempted.

As of May 1991, only a handful of releases had been granted by the applicable local authorities. The main reason for this hesitancy is the fact that the new federal states are already heavily indebted, currently are solely responsible for financing granted releases, and as a result do not possess the financial means to assume large amounts of environmental liability and the attendant future costs. If the federal government does

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A complete exemption can only be received if an investor acquires the contaminated assets themselves or acquires at least a 51% share interest in a company owning contaminated commercial property. If an investor controls less than 51%, he may only receive a partial release in proportion to his respective share interest. See Knopp, *supra* note 354, at 1358.

360 *See* TREUHAND, INVESTING IN EASTERN GERMANY, *supra* note 2, at 16.

361 *See* Thieme, *supra* note 342, at 16.

362 *Id.*

363 *See* Altlasten: Die Zeit drängt, 1991 WW 180. The actual date of contamination is the date upon which the chain of events leading to the contamination first occurred. BUM, Release Regulation, § II(4). See also Dombert & Reichert, *supra* note 354, at 747.

364 *See* Thieme, *supra* note 342, at 14-15. As part of their duty of care ("Geschäftsführerpflicht"), executive management is obligated to take all measures advantageous for their companies, including applying for a release. Freistellungsverfahren nach Umweltrahmengesetz, 1991 TREUHANDINFO 7.

365 According to rough estimates by the Federal Environmental Ministry, a total of 2,000 applications have been filed, 52 have been processed, and a mere 13 have been granted as of October 1991. Telephone Interview with Mr. Schelberg, Bundesumweltministerium.

366 For a good analysis of the current financial and constitutional problems regarding this issue, see Rose, *Die Altlastenfreistellungsklauseln im Recht der neuen Bundesländer: Verfassungs- und Finanzierungprobleme*, 1991 BB 2100.
not take legislative steps to help finance this release opportunity, it will continue to be a well intended but practically inaccessible option for investors.

(v). Assumption of Environmental Cleanup Costs by the Treuhand

Although the Treuhand is not legally obligated to do so, recent statements indicate that it will pursue a very flexible approach in assuming environmental cleanup expenses. Nevertheless, before the Treuhand will assume any environmental liability, it requires investors to first file for a release from the appropriate federal state authorities. Such application, however, will in all likelihood not be processed before the sale of a company is completed, which reinforces the importance of negotiating with the Treuhand with respect to environmental costs and liability.

If an application has been filed with the appropriate federal state authorities, the investor and the Treuhand are next to investigate whether overall environmental liability can be reduced by eliminating or divesting contaminated business assets before the sale is completed. Although the Treuhand has been additionally willing to assume a large portion of its companies’ potential environmental cleanup expenses, it seeks to structure its assumption in such a way as to give investors an incentive to help alleviate their environmental liability. As a result, the Treuhand typically requires an investor to assume a suitable fixed amount of the total estimated environmental cleanup costs in relation to the purchase price and at least 10% of the costs of environmental cleanup above such amount, although this determination is made on a negotiated case-by-case basis. The Treuhand seeks only to help cover the environmental cleanup costs required to remove any immediate danger and to facilitate the intended use of the property, and will only help cover environmental costs incurred up to a maximum of ten years after an acquisition. Steps taken to clean up environmental hazards are to be taken in close consultation with the Treuhand, and a cleanup which is not undertaken in close consultation with the Treuhand will not

367 TREUHAND, INVESTING IN EASTERN GERMANY, supra note 2, at 16; ACC, OPPORTUNITIES AND OBSTACLES, supra note 15, at 37.
369 TREUHAND, INVESTING IN EASTERN GERMANY, supra note 2, at 16.
370 Treuhand Environmental Guidelines, Rule 5(2).
371 Id., Rule 5(1).
372 TREUHAND, BUYING COMPANIES, supra note 6, at 22; TREUHAND, INVESTING IN EASTERN GERMANY, supra note 2, at 16.
Nevertheless, the Treuhand is particularly willing to offer entrepreneurial investors, as well as small and medium-sized corporate investors, a ceiling on any potential environmental liability where allowing the investor to assume unlimited liability is not in the interest of all the effected parties.

(vi). Recommendations

Given the exorbitant risks involved, investors should avoid purchasing contaminated property whenever possible. If there is any possibility of contamination, a thorough environmental assessment should be undertaken before acquiring any property. In the event that environmental contamination is uncovered or suspected, it is imperative that investors not only apply for a release from the appropriate local authorities but also negotiate with the Treuhand to obtain indemnities and/or releases from such liability.

Since a release from the local authorities is generally not to be expected before an acquisition is completed, a purchase agreement should address in detail the issue of existing and potential environmental liability. If the Treuhand is not in a position to assume a large proportion of environmental cleanup costs, investors should only conclude a purchase agreement on condition that a release from the local authorities is granted, or by reserving the right to rescind the purchase agreement or reduce the purchase price in the event such release is not granted. If third parties may be affected by contamination, exemption agreements with such third parties should also be sought.

In addition, if a release has already been previously granted to a former owner and/or purchaser, a subsequent purchaser should demand to receive either a successor in rights agreement with the applicable local authorities or a provision to the same effect in the release order itself.

Furthermore, many of the assistance and subsidy programs de-

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373 Treuhand Environmental Guidelines, Rule 5(3).
374 BDI, ENTREPRENEURSHIP, supra note 33, at 3.
375 See BUM, Release Regulations, §§ II(6), (10); Das Freistellungsverfahren nach Umwelt- trahmengesetz, 1991 TREUHANDINFO 7. A release application can be assigned through a successor in rights agreement. This option is particularly important when the investor can no longer himself file for a release as a result of a filing deadline having expired. If this option is utilized, the applicable local authority must be notified and the underlying release application should be modified accordingly. BUM, Release Regulations, § II(6).

The release itself, once granted, can also be assigned through a successor in rights agreement. Such assignment requires the prior approval of the local authorities, however, because the decision to grant the initial release may have been based on factors relating to the former title holder which may be different with respect to the current investor. Id. § II(10). The local authorities have been instructed upon granting releases to list the conditions or basis of such grant, if any. Id. In this respect, it is recommended that an acquiror seeking to be assigned an existing release submit a statement to the local authority explicitly setting forth his case.
scribed in section IV herein also apply to environmentally-oriented investments, which may help to lower an investor's overall environmental cleanup and pollution-prevention expenses.\textsuperscript{376}

e. Outstanding Debt Obligations and Unwanted Assets

Many of the companies held by the Treuhand have had or continue to have sizable amounts of outstanding debt that should be listed in their financial statements. Under the planned market system in former East Germany, companies were required to transfer any surplus funds to a central planning authority which then in turn decided how much such company should receive for reinvestment. Thus, it was often in a company’s interest to not have any surplus at all. In practice, this procedure led companies to amass large amounts of debt, because they never had an incentive to make a profit or cut costs. Even though these debts were effectively halved as a result of a provision in the DM Accounting Act allowing companies in former East Germany to transform their Ost-Mark assets and liabilities into Deutsch Marks at a generous rate of 2:1, the Treuhand was nevertheless saddled with the daunting task of servicing corporate debt obligations amounting to approximately DM 100 billion.\textsuperscript{377} In addition, in order to provide companies it held with liquidity directly after the monetary union in mid-1990, the Treuhand furnished such companies with a liquidity credit amounting to DM 28 billion.\textsuperscript{378}

Nevertheless, overindebted companies (i.e., where liabilities exceed assets) may book a receivable (“equalization claim”) with the Treuhand in order to eliminate their overindebtedness.\textsuperscript{379} The Treuhand has discretion to either accept or refuse to book such receivable based on its evaluation of each company's financial viability.\textsuperscript{380} These liabilities should be addressed as part of a negotiated settlement, and the Treuhand has been willing to assume most, if not all, of such outstanding debt obligations.

Many of the transformed companies also hold assets that are unre-

\textsuperscript{376} See BMU, ECOLOGICAL DEVELOPMENT, supra note 337, at 68-69; BMU, ÖKOLISCHER AUFBAU: WEGWEISER ZU STARThILFEN IM UMWELTSCHUTZ (May 1991).

\textsuperscript{377} TREUHAND, BUYING COMPANIES, supra note 6, at 22. Interest payments on this debt to be made by the Treuhand amounted to DM 13 billion for 1991 alone. \textit{Id}.

\textsuperscript{378} \textit{Id}.

\textsuperscript{379} DM Accounting Act, § 24; Verordnung über Massnahmen zur Entschuldung bisher volkseigener Unternehmen von Altkrediten (Entschuldungsverordnung) [EntschVO], GBl.DDR I, at 1435, § 2 (Sept. 14, 1990). As of September 1991, financially viable companies had booked such receivables with the Treuhand amounting to DM 18 billion, and it is estimated that this amount could rise to as high as DM 70 billion. \textit{Treuhand benötigt 1992 mehr Spielraum}, 1991 TREUHANDINFO 2.

\textsuperscript{380} EntschVO §§ 2(2)-(3).
lated to their business activities and the Treuhand has shown an understandable preference for ridding itself of unwanted assets by selling all the assets owned by a company. Even if the Treuhand is not willing to assume unwanted assets, the additional time and expense in managing or selling such unwanted assets should be included in a negotiated settlement with the Treuhand.

f. Contractual Representations and Warranties.

Prospective investors typically request certain representations and warranties of a standard nature during their negotiations with the Treuhand. For example, investors typically request the Treuhand to provide a warranty as to the accuracy and completeness of the opening financial statements provided for a target business. As a general rule, the Treuhand seeks to limit its financial exposure to the amount of the purchase price, which means that the Treuhand is highly reluctant to agree to any potentially costly representations or warranties, including those regarding the correctness of financial statements or the environmental condition of commercial property. The Treuhand is also reluctant to agree to any such representations or warranties, because the investor in most cases typically knows far more about a targeted company than the Treuhand as a result of due diligence which the investor has undertaken. If the Treuhand does agree to any representations and warranties, it will generally limit its exposure to what the investor did not know or should not have known.

Thus, in order to retain symmetry in the negotiating process, any standard representations and warranties regarding contractual or other risks which the Treuhand attempts to impose on an investor should be individually negotiated.

IV. INVESTMENT INCENTIVES AND SUBSIDIES

As of mid-1991, roughly 200 investment incentive and subsidy programs existed in Germany for businesses, entrepreneurs and professionals, and over fifty of these programs were specifically earmarked for the

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381 See supra notes 80-87.
382 See ACC, OPPORTUNITIES AND OBSTACLES, supra note 15, at 38; Scheifele I, supra note 169, at 562. Investors wishing not to assume all the assets of a targeted company should contemplate concluding an "asset deal" as opposed to a "share deal," which may result in substantial tax advantages. See Scheifele I, supra note 169, at 561-62.
383 This section is not meant to be a comprehensive summary of the numerous financial assistance subsidies, government grants, below-market rate loans and guarantees, and tax incentives that are currently available, but rather a general overview of the incentives and subsidies available for businesses or individuals wishing to invest in the new federal states. An overview of investment incentives and two investment incentive scenarios are included in Appendix C and Appendix D respectively.
new federal states. Most of these incentives and subsidies are also available for foreign investors, although such investors are usually required to establish a business presence of some kind in the new federal states. Additionally, investors generally may take simultaneous advantage of nearly all the incentives and subsidies described below.

Application procedures vary depending on the type of investment assistance sought. Formal applications for federal assistance supported by detailed information typically must be filed with the local tax office by September 30 of the year directly following the year of investment. Applications for state assistance typically should be submitted to the Ministry of Economic Affairs of the federal state in which the business activity is located and should be discussed thoroughly with such ministry before commencing investment. Nevertheless, application procedures for some of the programs may differ, and those wishing to take advantage of one or more of the programs should fully familiarize themselves with such procedures before making any sizable investment by contacting one of the local chambers of commerce in the new federal states for assistance.

For good descriptions of these various investment incentive and subsidy programs in the new federal states, see Bundesministerium für Wirtschaft, Wirtschaftliche Förderung in den neuen Bundesländern (Aug. 1991) [hereinafter BMWi, Assistance Programs]; American Chamber of Commerce in Germany, Investment in Eastern Germany: Investment Incentive Programs (Jan. 1991) [hereinafter ACC, Investment Incentive Programs]; Brockhoff-Hansen, Fördermittel für die neuen Bundesländern, 1991 DStR 480; Norddeutsche Landesbank Girozentrale, Ost-Aktuell Förderprogramme (6 ed., Nov. 1991). For a good overview of the programs available throughout Germany, see Bundesministerium für Wirtschaft, Förderungsmassnahmen in den alten Bundesländern für mittelständische Unternehmen, Freie Berufe und Existenzgründungen (Aug. 1991) [hereinafter BMWi, West German Programs]. The number of investment incentives available for investors in the new federal states is so large that the use of services offered by investment specialists is now typically required to maximize such opportunities. Nevertheless, the Treuhand's Business Finance Group ("Abteilung Unternehmensfinanzierung") now offers a computer search capability which compares an investment's basic characteristics with the requirements and conditions of all available investment incentives. Those interested should contact Mr. Engelhardt at the Treuhand in Berlin by phone at (049)(30)2323-2955. Auskunft über Wirtschaftsförderung per Computer, 1990 TreuhandInfo 9. In addition, the Kreditanstalt für Wiederaufbau ("Reconstruction Credit Authority") offers a similar program in Berlin (Internationales Handelszentrum, Friedrichstrasse 10, O-1086 Berlin, Germany, Tel. (030) 264 32045, Fax (030) 264 32084). Beratung für ausländische Investoren, 1991 TreuhandInfo 16.

In accordance with a recent EC Commission decision on April 11, 1991 (which was not publicly made available), however, combined non-tax investment incentives may not exceed 35% of the total investment. See Peter Schütterle, EG-Beihilfekontrolle über die Treuhandanstalt: die Entscheidung der Kommission vom 18.9.1991, 1991 EuZW, Nov. 10, 1991, at 662, 663 n.5. Many of the investment incentive programs have come under criticism for not being specifically designed for the existing circumstances and needs in the new federal states. For example, many of the Eastern German companies are operating at a loss and as a result cannot benefit in the short term from special depreciation allowances and other tax incentives. See BDI, ENTREPRENEURSHIP, supra, note 33, at 1.
ance or by utilizing the services of local professionals with investment expertise. Once an application has been filed, periodic inquiries should be made to speed up processing given the currently poor administrative capabilities in Eastern Germany at the state and local levels. Although not described directly below, consulting services, job training programs, government subsidized participation at foreign trade fairs, and other similar programs may also be available for qualified investors.

A. Investment Grants

1. Federal Investment Grants

Investment grants from the federal government ("Investitionszulagen") are available for the purchase or production of new depreciable fixed assets and subsequent improvements and additions to such assets which are made in the new federal states during the period between December 31, 1990 and January 1, 1995. Investment grants constitute a form of direct financial investment assistance, which is independent of turnover and company success, and is aimed at stimulating economic development in the new federal states. The five new federal states are equally promoted, there are no regional differentiations, and there are no restrictions based on citizenship or domicile.

The investment grant is earmarked for the purchase or production of new tangible assets within the new federal states. Assets not eligible for investment grants are automobiles, airplanes, used assets, and assets...

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386 For a list of such chambers, see ACC, INVESTMENT INCENTIVE PROGRAMS, supra note 384, at 4-6.
387 See generally BMWI, ASSISTANCE PROGRAMS, supra note 384.
388 Investment grants were first made available through the Verordnung über die Beantragung und die Gewährung von Investitionszulagen für Anlageinvestitionen, GBl.DDR I, at 621 (July 17, 1990) [hereinafter GDR Investment Grant Ordinance], which was promulgated by the East German government on July 4, 1990, supplemented on September 13, 1990 (see GBl.DDR I, at 1489), and later incorporated into the West German tax law through the Unification Treaty. Unification Treaty, supra note 1, appen. II, chap. IV, § III(3). For a good overview of the GDR Investment Grant Ordinance, see Investitionszulage für Investitionen im beigetreten Teil Deutschlands (Fördergebiet), 1990 DB (DDR REPORT) 3148. A new law now retroactively applies to qualified investments made after January 1, 1991. Investitionszulagengesetz 1991, BGBl. I, at 1333 (June 24, 1991) [hereinafter Investment Grant Law]. For a good overview of the Investment Grant Law, see Stuhrmann, supra note 45, at 2608. For regulations from the Federal Tax Ministry interpreting both the GDR Investment Grant Ordinance and the Investment Grant Law, see Bundesministerium für Finanz, Betr.: Gewährung von Investitionszulagen nach der Investitionszulagen-verordnung und nach dem Investitionszulagengesetz 1991, BGBlI, at 768 (Aug. 28, 1991).
389 Investment Grant Law, § 3. Investment grants are to be processed and paid at the end of the business year in which the investment is concluded. Id. § 7(2). Applications must be filed with the tax authorities by September 30: (i) of the year following the year of asset acquisition or production, (ii) of the year in which the overall production costs accrue, or (iii) of the year when such costs are paid. Id. § 6(1).
390 Id. § 2.
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whose value does not exceed DM 800.\textsuperscript{391} Qualifying assets must remain in the business for at least three years following their purchase or production and cannot be used more than 10\% during this period for private purposes.\textsuperscript{392} Investment grants are not treated as taxable income and do not reduce the applicable asset's cost basis for depreciation purposes.\textsuperscript{393} Investment grants are calculated as a percentage of the sum of the purchase and production costs attributable to the eligible assets incurred during a particular business year.\textsuperscript{394}

The general rate applicable for investment grants for the period from December 31, 1990, to July 1, 1991, amounts to 12\%, and from June 30, 1992, to January 1, 1995, amounts to 8\%.\textsuperscript{395} Moreover, an 8\% investment grant shall be available if the party entitled to the grant commences purchase and production in the new federal states before December 31, 1994.\textsuperscript{396} Recipients of investment grants are not excluded from concurrently taking advantage of the taxable investment subsidies and special depreciation allowances described below.

2. Federal Savings Grants

The federal government provides savings grants for those individuals, including foreigners, who are saving in order to establish a business in the new federal states.\textsuperscript{397} The savings grant amounts to the lesser of 20\% of the amount saved or DM 10,000, and the savings period must be between three and ten years.\textsuperscript{398} Grant proceeds are issued once the savings are completed and a business has been commenced.\textsuperscript{399}

3. Local Investment Grants

Upon application with one of the federal states, taxable investment subsidies ("Investitionszuschüsse"), in addition to federal tax-free grants, are available up to February 28, 1995.\textsuperscript{400} The federal government, state

\begin{footnotes}
\item[391] Id.
\item[392] Id.
\item[393] Id. \textsuperscript{\%} 10.
\item[394] Id. \textsuperscript{\%} 4.
\item[395] Id. \textsuperscript{\%} 3.
\item[396] Id.
\item[397] BMWI, ASSISTANCE PROGRAMS, supra note 384, at 24-25.
\item[398] Id.
\item[399] Id. Information regarding federal savings grants can be obtained from all banks in Germany or directly through the German Settlement Bank ("Deutsche Ausgleichsbank").
\item[400] Gesetz über die Gemeinschaftsaufgabe "Verbesserung der regionalen Wirtschaftsstruktur," BGBl. I at 1861 (Oct. 6, 1969), as last amended by Unification Treaty, supra note 1, append. I, chap. 5(A), \textsuperscript{\%} III, and 1991 Tax Reform Act, art. 11; Richtlinien des Bundeswirtschaftsministeriums über Voraussetzung, Art und Intensität der Förderung mittels Investitionszuschüssen, Bundestagsdrucksache 11/7501, at 20 (Aug. 1990) (regulations for the general assistance program set forth in article 28 of the Unification Treaty) [hereinafter Local Investment Grant Regulations]. See generally JAS-
\end{footnotes}
governments, and the European Community have made available DM 4 billion per year over the next five years for this program.\textsuperscript{401} Qualifying assets may neither be land nor transportation vehicles, but unlike federal investment grants, may be assets that have already been utilized.\textsuperscript{402} They must remain in the business for at least three years or be replaced by an asset of the same or higher value.\textsuperscript{403} Investors must show that the planned investment can reasonably be expected to be profitable, that jobs are to be secured or created, and also that sales comprising more than 50% of production are to occur within thirty kilometers of the investment site.\textsuperscript{404} The maximum rates applicable for investment subsidies are 23\% for the establishment of a new business,\textsuperscript{405} 20\% for the expansion of an existing business,\textsuperscript{406} and 15\% for the reorganization or rationalization of an existing business.\textsuperscript{407} Such subsidies may be combined with federal investment grants, special depreciation allowances, and subsidized loans so long as they do not exceed a subsidy cap of 35\% for the total investment imposed by the European Community.\textsuperscript{408} A similar subsidy program is also available for investment projects aimed at improvement of the regional commercial infrastructure in the new federal states.\textsuperscript{409}

B. Loans

Loans are available at favorable terms, mainly to small and medium-sized businesses, on both the federal and state levels. On the federal level, loans are available from the federal government directly, the Euro-

\textsuperscript{401} BMW\textit{i}, \textit{ASSISTANCE PROGRAMS}, supra note 384, at 13-17.

\textsuperscript{402} Local Investment Grant Regulations, § 1(2). In addition, investment in the construction or improvement of infrastructure may also qualify for local investment grant assistance. See \textit{id.} § 8.

\textsuperscript{403} \textit{id.} § 2(3).

\textsuperscript{404} \textit{id.} §§ 2(1)-(2). Businesses in the following business sectors do not qualify for such assistance: (i) transport and warehousing, (ii) agricultural and forestry (except processing), (iii) wholesale trade in consumption goods (except import and export wholesale trading), (iv) medical care facilities, and (v) retail sales (except mail order). \textit{id.} § 3.

\textsuperscript{405} \textit{id.} §§ 4(1), (4). Included in this category are acquisitions of an already existing business which is threatened with bankruptcy. \textit{id.} § 4(4).

\textsuperscript{406} \textit{id.} §§ 4(1), (2). In order to qualify under this category, investors must guarantee either that at least a 15\% increase in the existing permanent workforce will occur or that at least 50 new permanent jobs will be created (apprentices are counted twice). \textit{id.} § 4(2).

\textsuperscript{407} \textit{id.} §§ 4(1), (3). With respect to a reorganization or rationalization of an existing business, investors must protect existing jobs and the investment amount must be at least double the average annual depreciation of the qualifying business over the last three years (excluding special depreciation). \textit{id.} § 4(3).

\textsuperscript{408} See \textit{id.} § 2(4).

\textsuperscript{409} See BMW\textit{i}, \textit{ASSISTANCE PROGRAMS}, supra note 384, at 13-19.
European Recovery Program (ERP), the European Investment Bank (EIB), the Reconstruction Credit Authority ("Kreditanstalt für Wiederaufbau"), the German Settlement Bank ("Deutsche Ausgleichsbank"), the Treuhand, and other federal agencies and organiza-

410 Long-term, below-market, fixed-rate loans up to a maximum amount of DM 1 million are available for the establishment of companies and investments in the new federal states. Eligible recipients are individuals, small and medium-sized privately-held businesses, and professionals. These loans are available through financial institutions throughout Germany. See BMWi, Assistance Programs, supra note 384, at 26-31; ACC, Investment Incentive Programs, supra note 384, at 7-9. For a good overview of the numerous programs available under the ERP, see Bundesministerium für Wirtschaft, Die ERP Programme 1991 (June 1991).

411 The European Investment Bank (EIB), an EC institution, provides funds for infrastructure development, modernization and restructuring of industry, and small business investment projects serving EC interests. Loan maturities range from seven to twenty years at favorable rates. See BMWi, Assistance Programs, supra note 384, at 43-45; ACC, Investment Incentive Programs, supra note 384, at 15.

The European Bank for Reconstruction and Development (EBRD) was established in March 1991 and will act as the funnel for EC aid allocations to Central and Eastern Europe. See Agreement Establishing the European Bank for Reconstruction and Development, 1990 O.J. L372/1. The main purpose of the EBRD is to support the transition to free market economies and to promote private and entrepreneurial initiative in Central and Eastern European countries committed to the principles of multiparty democracy, pluralism, and free markets. It is expected that the EBRD will lend approximately ECU 600 million in 1991. For a good overview of this institution, see Takao Suami & Gerwin van Gerven, New Legal Framework for Trade Relations Between the European Community and the Central and Eastern European Countries, 1991 INT'L BUS. LAW. 149, 153.

412 This investment loan program is aimed at promoting the formation, security, and expansion of small- and medium-sized businesses within the new federal states. Special consideration is given to investments seeking to improve the environmental situation. These loans can be received in connection with other financial assistance, including ERP loans and capital investment assistance. Loans are for a period of ten years with a maximum amount of DM 10 million and with repayment commencing at the latest by the beginning of the third year. A fixed interest rate is charged taking into account the prevailing structure of interest rates. See BMWi, Assistance Programs, supra note 384, at 31-35; ACC, Investment Incentive Programs, supra note 384, at 11.

413 This institution offers subsidized financing through two programs. First, the so-called "Capital Investment Assistance Program" offers initial share capital assistance to promote the creation of independent small businesses and the increase of professionals in the new federal states amounting to a maximum loan amount of DM 350,000 for individuals, German or foreign, who are no older than fifty years of age and who have proven technical and business qualifications, as far as these are required to carry out their respective businesses. Recipients must prove that without initial financial assistance the starting of the business would be made considerably more difficult and that the recipient can furnish or acquire additional capital requirements, which can be either cash or non-cash assets. No interest charges will accrue in the first three years. Thereafter, the interest rate will increase annually to 2% in the fourth year, 3% in the fifth year, and 5% in the sixth year. The applicable interest rate for the following ten years can then be adjusted according to the existing interest rate structure. The term for repayment is twenty years and the last payment must be made before the individual's seventy-first birthday. Applications must be submitted by December 31, 1991. See BMWi, Assistance Programs, supra note 384, at 20-23.

Second, loans are offered to those seeking to promote the formation of self-sufficient small businesses, the relocation of business out of residential areas and into designated business areas, and the promotion of innovation. Recipients of these loans may be individuals, professionals, or small and medium-sized businesses who invest in the new federal states. Cases of rehabilitation or reorganiza-
tions. On the state level, subsidized loans may also be available from local banks and federal state agencies.

In addition, U.S. investors may receive favorable loan financing, loan guarantees, and political risk insurance for investment projects in the new federal states from the Overseas Private Investment Corporation (OPIC), a U.S. government agency.  

C. Guarantees

Loan guarantees are available from the ERP and the federal or state governments for certain investment purposes where loan financing could not otherwise be obtained. Federal, state and private export credit guarantees are also available to cover economic, political, credit and similar risks. Additional guarantees are also provided against currency risks involving foreign exchange losses.

D. Tax-Free Reserves

1. Replacement of Assets

A German business that realizes a capital gain upon the sale of qualifying fixed assets or real property may defer the tax on 50% (100% for land and buildings) of such gain, provided that the assets have been owned for a minimum of six years. Tax deferral is achieved by creating a tax-free reserve if the replacement asset is acquired at a later date or by deducting the tax-free amount directly from the replacement cost if the replacement asset is acquired in the year of disposal. A reduced cost basis is used to calculate the replacement asset's depreciation, which will not be given consideration. Except in exceptional circumstances, the maximum loan amount is DM 1.5 million. Loans may be received for periods up to ten years with repayment beginning at the latest at the beginning of the third year. A fixed interest rate will be charged taking into account the prevailing structure of interest rates. See id. at 36-38; ACC, INVESTMENT INCENTIVE PROGRAMS, supra note 384, at 10-11.

414 As mentioned earlier, the Treuhand offers former state-owned companies capable of reorganization loan financing or guarantees at favorable conditions. See ACC, INVESTMENT INCENTIVE PROGRAMS, supra note 384, at 22.  

415 For more information, contact OPIC directly at 1615 M Street, N.W., Washington, D.C., 20527. OPIC has also established a $200 million fund ("Central and Eastern European Growth Fund") to be managed by Salomon Brothers Asset Management. OPIC provides political and currency risk insurance for the investments made by the fund. Set up as a venture capital fund, it will, along with local and/or U.S. investors, invest capital into Central and Eastern European businesses, hoping to make long-term profits. See Jason Huemer, OPIC Program Creates a Host of New Funds, 5 CORPORATE VENTURING NEWS, Dec. 1991, at 1-2.  

416 See BMWi, ASSISTANCE PROGRAMS, supra note 384, at 39-45.  

417 Id. at 87-91.  

418 Id. at 87-91.  

419 EStG § 6b(1).  

420 Id. § 6b(3).
allows the tax authorities to recoup this tax benefit over a period of years. The replacement asset must be acquired no later than four years after forming the reserve. Any reserve balance remaining at the end of this four-year period, plus an interest charge of 6% for each year of the reserve's existence, must be added back to taxable income.

2. Price Increases

If the replacement cost of certain qualifying goods held by a business for processing or resale has increased by more than 10% during a fiscal year, a tax-free reserve may be established for the excess over such 10% increase. Reserve amounts must be added back to taxable income within six years of the reserve's creation.

3. Transfer of Depreciable Fixed Assets

A taxpayer resident in Germany who recognizes gain upon the transfer of depreciable fixed assets to a company or permanent establishment in the new federal states, in exchange for shares in such business entity, may defer inclusion of such gain in taxable income by creating a tax-free reserve up to the amount of the difference between the market value and the book value of such transferred asset. Apart from potentially favorable tax deferral benefits, the formation of a tax-free reserve can also result in a substantial financing advantage, because the reserve may be added back to taxable income beginning at the latest in the tenth year following its formation at an annual rate of at least 10%. In order to qualify for such treatment, assets must be transferred to a sub-

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421 Id.
422 Id.
423 Id. § 6b(6).
424 Einkommensteuerdurchführungsverordnung [EStDV], § 74.
425 Id.
426 The transfer of assets by a taxpayer subject to unlimited tax liability to its permanent establishment, to its sole proprietorship, or to a partnership in which it has an interest located in the new federal states has been afforded the same tax treatment as that applicable to corporations. Statement of the Bundesministerium für Finanz, 37/1990 at 2135 (July 30, 1990). Thus, an immediate triggering of capital gains liability is thereby deterred upon the transfer of assets by a Western German taxpayer to its permanent establishment, its sole proprietorship, or a partnership located in one of the new federal states.
428 GDR Investment Act, § 1.
subsidiary or permanent establishment in the new federal states before January 1, 1992.429

4. Startup Losses

In principle, losses of companies cannot be recognized by their shareholders for tax purposes, because a corporation and its shareholders are considered under German law to be separate legal persons. Losses generally can be upstreamed between affiliated corporations (so-called "Organschaft") where a profit and loss pooling agreement exists between such corporations.430 In order to do so, however, the subsidiary corporation must be financially, economically and organizationally integrated with its parent corporation.431 Nevertheless, taxpayers with unlimited tax liability432 who do not participate in a pooling agreement433 may, under certain circumstances, form a tax-free reserve for startup losses of a subsidiary or permanent establishment434 located in one of the new federal states.435

A company with at least a 10% direct interest in another company with its registered office and principal place of business in one of the new federal states may form a tax-free reserve for any startup losses incurred in the first five years after initial share acquisition.436 The reserve must be added back to taxable income to the extent the subsidiary realizes a profit and no later than five years after its formation.437 The reserve may only be formed if the acquisition of shares in a company in the new federal states occurs before January 1, 1992.438

429 Id. § 2. As of the end of December 1991, it was uncertain whether the federal government would continue to offer this tax incentive past January 1, 1992.
430 See KStG § 14.
431 Id. § 14(2).
432 EStG §§ 4(1),(5).
433 Unification Treaty, supra note 1, appen. I, chap. IV, § II(22)(b).
434 Due to a loophole in sections 2a and 3 of the German Income Tax Code when taken together, losses of a permanent establishment located in East Germany were previously not deductible from West German taxable income. Nevertheless, section 2a was amended to provide for the deduction by a German company of losses incurred by its permanent establishment located in the new federal states. See KALIGIN & COURTIER, BERATUNGSHANDBUCH: EIGENTUM UND INVESTITIONEN IN DEN NEUEN BUNDESLÄNDERN § 6220, at 12-15 (1991).
436 GDR Investment Act, § 2(1).
437 Id. § 2(3).
438 Id. § 7(3). As of the end of December 1991, it was uncertain whether the federal government would continue to offer this tax incentive past January 1, 1992.
E. Special Depreciation Allowances

1. Small and Medium-sized Businesses

Special depreciation allowances are available for small and medium-sized businesses doing business throughout Germany. In order to qualify for this special depreciation allowance, businesses must have less than DM 240,000 in total assets and less than DM 500,000 in taxable business capital for municipal trade tax purposes. In conjunction with normally permissible depreciation, qualifying businesses may in addition depreciate up to 20% of an asset’s acquisition or production cost in each of the first five years after acquisition or production. Total depreciation (i.e., special plus normal depreciation), however, may not exceed 100% of an asset’s initial depreciation cost basis.

2. Movable or Fixed Assets

Investors in the new federal states may take advantage of special depreciation allowances offered for investments made after December 31, 1990, and completed before January 1, 1995. Qualifying assets must be depreciable movable or fixed assets. Those qualifying assets which are movable must remain in the company or permanent establishment located in the new federal states for a period of at least three years following purchase or production, and may be used no more than 10% for private purposes during this period. In conjunction with normally permissible depreciation and investment grants, a special depreciation of up to 50% of a qualifying asset’s initial depreciation cost basis may be taken in the first five years after acquisition or production.

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439 EStG § 7(g). See also BMWi, West German Programs, supra note 384, at 16.
440 EStG § 7(g).
441 Id.
442 Gesetz über Sonderabschreibungen und Abzugsbeträge im Fördergebiet (Fördergebietsgesetz), BGBl. I, at 1322 (June 24, 1991) [hereinafter Regional Aid Law], comprising section 6 of the 1991 Tax Reform Act, supra note 45. See also Wewers, Steuervergünstigungen nach dem Gesetz über Sonderabschreibungen und Abzugsbeträge im Fördergebiet (Fördergebietsgesetz), 30/1991 DB 1539 (July 26, 1991); Stuhrmann, supra note 45, at 2606-07. Qualifying businesses who, for technical or other reasons, are not able to fully utilize the special depreciation allowance pursuant to sections 2 and 3 of the Regional Aid Law may establish a tax-free reserve up to the amount of such special depreciation allowances for investments which were begun before January 1, 1992. Regional Aid Law, § 6(1). See also Stuhrmann, supra note 45, at 2607; Wewers, supra note 442, at 1543-44. Such reserve, however, may not exceed DM 20 million in any particular business year, and must be set-off by the amount of permissible special depreciation at the latest during the first business year following December 31, 1992. Regional Aid Law, § 6(2). Reserves that are not set-off in conjunction with permissible depreciation are to be charged a penalty interest rate of 6% in order to prevent abuse. Id. § 6(3).
443 Id. §§ 2, 3.
444 Id. § 2.
445 Id. § 4(1).
3. New Construction, Modernization or Expansion of Buildings

Special depreciation allowances with largely the same benefits as those described in subsection 2 above are also afforded to investors who construct, or acquire within one year of construction, buildings in the new federal states, as well as to investors who undertake modernizations or expansions thereto. Such special depreciation applies, among other things, to rental apartments, one or more family homes, and warehouses or supermarkets which are privately owned and leased to businesses. Although qualified investors must not reside in one of the new federal states, they must nevertheless have a business presence there. In addition to benefitting from a 50% special depreciation allowance over a five year period, qualified investors usually may also deduct the normal annual straightline depreciation of 2% which is applicable to buildings.

F. Indirect Incentives

In addition to the above direct incentives, investors may also reap indirect benefits in the form of local infrastructure development. Local governments are eligible through regional development programs for preferential financing in constructing, among other things: (i) commercial and industrial facilities; (ii) transportation links to and from a commercial business; (iii) energy and water supply systems; and (iv) waste disposal and water treatment facilities.

G. Phasing Out of Certain Western German Assistance Programs

In order to promote economic growth in certain depressed Western German regions bordering the former East German border, including West Berlin, businesses investing in such regions have up until now been offered a number of investment incentives. The purpose underlying such investment incentives, however, has largely become superfluous given the pressing economic situation in the new federal states, and the European Community has indicated that continuation of such incentives is now in

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446 Id. § 3. See also Schumm, “Ost-Investoren geniessen attraktive Steuervorteile”, Süddeutsche Zeitung, Oct. 26, 1991, at 143, col. 1. If construction of a qualifying building is not completed on or before December 31, 1994, the special depreciation allowance will only apply to the construction costs incurred up to such date. Regional Aid Law, § 8(1).

447 See Schumm, supra note 446, at 143; Stuhrmann, supra note 45, at 2606.

448 Regional Aid Law, § 1.

449 See Schumm, supra note 446, at 143; Stuhrmann, supra note 45, at 2607. Within the first five years, 60% of the cost of construction or acquisition can therefore be depreciated. The remaining 40% can thereafter be depreciated at a 2% annual rate over the following twenty years. Modernization costs for buildings constructed prior to 1925 are depreciated at a normal annual rate of 2.5%. See Schumm, supra note 446, at 143; Stuhrmann, supra note 45, at 2607.

450 See BMWi, ASSISTANCE PROGRAMS, supra note 384, at 106-108.
contravention of the EC Treaty. As a result, recent legislation calls for the incremental phasing out of these investment incentives by the end of 1994.

V. STATUS WITHIN THE EUROPEAN COMMUNITY

Upon reunification of the two Germanies, the new German federal states were effectively incorporated into the European Community and became subject to EC law, modified by specific transitional arrangements adopted or to be adopted by the competent EC institutions. The goal of these transitional measures is to have EC law fully applicable in the new federal states by December 31, 1992, with the exception of a few areas, particularly environmental legislation, which will require a longer transitional period. The transitional measures are meant to be confined to what is strictly necessary to fully integrate the new federal states into the EC as soon as possible.

After the European Community first officially signified its support for German reunification at a special meeting in Dublin on April 28, 1990, the EC Parliament through its Temporary Committee on German Unification worked closely with the West German government and the EC Commission to determine the implications of reunification for the European Community. In addition, the various EC Parliament committees each analyzed the implications of reunification on their respective areas of responsibility. The EC Commission also prepared studies re-

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451 EC UNIFICATION BULLETIN, supra note 7, at 75. See also IL&T, supra note 9, at 17.
452 1991 Tax Reform Act, §§ 4, 5. See also Stuhrmann, supra note 45, at 2608.
453 Unification Treaty, supra note 1, chap. IV, art. 10.
455 Some commercial sectors in the new federal states will have considerable difficulties in complying with EC legislation, in particular with safety and quality standards, environmental legislation, and structural policy. See EC UNIFICATION BULLETIN, supra note 7, at 45, 184-93.
456 The general criteria utilized by the European Community in formulating the transitional measures were as follows:

(i) acceptance of the 'acquis communautaire' must be both the starting point and the ultimate objective;

(ii) any transitional arrangements must be warranted on objective economic, social, or legal grounds; and

(iii) any exceptions or derogations must be temporary and cause as little disturbance as possible to the functioning of the common market (proportionality). Id. at 44.
garding the effects of reunification on the European Community's external relations, common market, social affairs, consumer protection, environmental and nuclear safety, research and technology, telecommunications, agricultural policy, transportation, and energy, as well as the European Coal and Steel Community. In culmination of these efforts, the EC Commission in August 1990 proposed a series of transitional measures which were adopted by the EC Council in December 1990.

A. Customs Union

Imports from third countries into the new federal states are now generally subject to the same customs duties, quantitative restrictions, and other EC customs union legal measures as other imports into the European Community. In this respect, a problem arose concerning trade agreements existing between the former East German government and one of the COMECON countries or Yugoslavia. In response, the

458 Id. at 27-29.
459 See O.J. Eur. Comm. (No. L353) 1-8 (Dec. 4, 1990); "The Community and German Reunification," Com (90) 400 Final. Since the EC Council was not initially in a position to competently review the EC Commission's proposals for transitional measures, the EC Council authorized the EC Commission to take interim measures. Council Regulation (EEC) No. 2684/90 (Sept. 17, 1990). See also EC UNIFICATION BULLETIN, supra note 7, at 46. In this regard, during the interim period up to early December 1990, the German government was allowed to maintain legislation concerning the new federal states which did not comply with EC legislation. Commission Decision 90/481/EEC (September 27, 1990).
460 Import and export regulations for all EC member states are determined by the EC Commission and therefore are applicable to imports or exports from Germany. No customs duties are levied on trade activities among EC member states. The majority of goods originating outside of the European Community are potentially liable for the payment of import duties upon importation into Germany. Reduced or zero duty rates may apply to commodities from countries with which the European Community has special trade agreements. The majority of import duties are levied based on a certain percentage of the value of the goods. Specific duties based on weight or quantity may also apply, but such duties generally apply solely to agricultural products. The classification and valuation of imported goods for import duty purposes is highly complex and governed by international agreements entered into by the EC Commission on behalf of the EC member states. The import and export of goods is generally free of restrictions, except for trade in agricultural products which is complicated by the relatively restrictive agricultural policy of the European Community.
461 For a comprehensive list of such trade agreements, see EC UNIFICATION BULLETIN, supra note 7, at 59-64. Even though the former East German government entered into trade agreements with a number of countries, its trade relations with the COMECON countries and Yugoslavia were and continue to be of major importance representing about 70% of East German trade prior to 1990, of which 40% was with the Soviet Union. See id. at 13, 52, 65-66 (breakdown and overview of Eastern German trade with these countries). Where the subject matter of a trade agreement comes within the exclusive jurisdiction of the European Community and not that of Germany, the European Community is to carry out all necessary renegotiation with the affected third country in compliance with normal EC procedures. See id. at 47. As a result, the European Community has or will use one of the following approaches: (i) request the German government to unilaterally rescind the trade agreement; (ii) request renegotiation based on standard EC procedures; (iii) grant temporary authorization to permit the German government to fulfill its treaty obligations; (iv) restrict the terri-
European Community agreed to suspend customs duties and the like up to December 31, 1992, with respect to trade agreements under which former East Germany was obligated to purchase specific quantities or pay specified prices for products originating from Yugoslavia or one of the COMECON countries. If such suspension of customs duties causes substantial injury to EC producers of similar or substitute goods, the EC Commission has reserved the right to invoke normal duties on such goods.

B. Internal Market

The new federal states have become fully integrated into the EC internal market, and all EC Treaty provisions pertaining to the free movement of goods, services, persons, and capital now apply in full. Furthermore, EC legislation regarding the free movement of labor, equal opportunity, employment protection, social security, health and safety, and EC vocational programs came into force in the new federal states upon reunification.

Goods manufactured in the new federal states not complying with EC directives may not move freely within the internal market, but may still be marketed within the new federal states if major adjustments to production are required to bring certain products into compliance with such EC directives. Up to December 31, 1992, the German government may continue to keep in force domestic legislation concerning such products which are in contravention of EC directives so long as such legislation does not work to the detriment of goods manufactured elsewhere within the European Community but marketed in the new federal states. This exemption is also applicable to products originating from one of the COMECON member states or Yugoslavia and imported into

torial scope of the trade agreement strictly to the new federal states; or (v) make an autonomous adjustment of EC law. See id. at 48; Suami & van Gerven, supra note 411, at 151.

Council Regulation (EEC) No. 3568/90 (Dec. 4, 1990). An importer coming under one of these trade agreements must obtain a license from the German authorities and assure that the pertinent goods will either be consumed in the new federal states or undergo processing sufficient to bring it up to EC standards. Suami & van Gerven, supra note 411, at 151.

EC Treaty, arts. 30-36.

Unification Treaty, supra note 1, chap. IV, art. 10.

Id.

O.J. L 203 (July 31, 1990). See also EC UNIFICATION BULLETIN, supra note 7, at 38; Suami & van Gerven, supra note 411, at 150.

the new federal states. Furthermore, the German government is responsible for preventing the marketing of Eastern German products (and other exempted products) not complying with EC directives in other regions of the European Community.

C. Competition Law

Competition law in Germany is based on the Law Against Restraints of Competition ("Gesetz gegen Wettbewerbsbeschränkungen" or "GWB") and on the competition rules and antidumping regulations of the European Community. The national laws are enforced by the federal cartel office ("Bundeskartellamt"), and compliance with the EC rules is overseen by the EC Commission. EC competition law also became applicable in the new federal states upon reunification. The EC Commission has indicated, however, that business activities within the new federal states which restrict competition will be looked upon less unfavorably than in other EC regions.

1. Mergers and Acquisitions

a. German Merger Controls

German antitrust regulations are fairly similar to those in force in the United States and cover, among other things, mergers and acquisitions, monopolies, and horizontal and vertical restraints on trade. In addition to mergers which restrict competition, the GWB also generally restricts or bans business practices such as: (i) price fixing; (ii) restriction of production, purchasing or selling; (iii) boycotts of suppliers or purchasers; (iv) allocation of markets, customers or suppliers; and (v) particular restrictions on licensees.

Although monopolies and market dominance are not necessarily illegal, the GWB prohibits the abuse of a market dominant position. Where an abuse is found, the Federal Cartel Office may restrict or forbid the abusive practice, invalidate contracts related to such practice, or impose fines. Market dominance revolves around an analysis of a com-

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469 Id.
470 Id. See also EC UNIFICATION BULLETIN, supra note 7, at 45-46.
471 See articles 85-90 of the EC Treaty and secondary legislation. See also EC UNIFICATION BULLETIN, supra note 7, at 74-75.
472 EC UNIFICATION BULLETIN, supra note 7, at 75.
473 Gesetz gegen Wettbewerbsbeschränkungen [GWB], §§ 16-17.
474 Id. § 18.
475 Id. § 26.
476 Id. § 1.
477 Id. §§ 20-21.
478 Id. § 22(4).
479 Id. §§ 24(2), 38, 39. Violations of the GWB may result in treble damages based on the
pany's financial power, its access to sales and supply markets, interlocking arrangements it may have with other companies, or legal or factual barriers it has erected to hinder market entry by potential competitors.\(^4\)

With respect to a merger, such a transaction is generally prohibited when it is expected that as a result of the merger a company will dominate the market or its dominating position will be strengthened, unless the participating companies can show that the merger will also improve the competitive environment and that such improvement will outweigh the detrimental effects of market domination.\(^4\) In making such determinations, the Federal Cartel Office takes into account the worldwide operations of a holding company conglomerate or parent company, even if a subsidiary resident in Germany is making the acquisition, which means that even a small acquisition by a foreign company or its subsidiary may come within the purview of the Federal Cartel Office.\(^4\)

As a general rule, a transaction in which one company acquires at least 25% of another German company must be reviewed by the Federal Cartel Office.\(^4\) A merger must be reported immediately to the Federal Cartel Office if the participating companies have a combined turnover of

\(^{480}\) Id. § 22(4). See also IL&T, supra note 9, at 9.

\(^{481}\) Id. §§ 24(1)-(2).

\(^{482}\) Id. § 23(1). See also IL&T, supra note 9, at 6.

\(^{483}\) GWB § 23(2). See also IL&T, supra note 9, at 9.
at least DM 500 million. If one of the participating companies had sales of at least DM 2 billion in the preceding business year or at least two of the participating companies individually had turnover of at least DM 1 billion in the preceding business year, however, they must notify the Federal Cartel Office upon forming an intent to undertake a "merger project" and must be prepared to furnish the Federal Cartel Office with extensive information for its review. Companies acquiring at least a 25% interest in another company but not falling within one of the above categories do not require prior approval by the Federal Cartel Office and need only register the transaction upon completion "without delay." For purposes of calculating annual company turnover, the Federal Cartel Office takes into account the worldwide operations of a holding company conglomerate or parent company.

Where the Federal Cartel Office determines that a market dominating position would be created or strengthened by a merger, it may prohibit the transaction or require dissolution. The Federal Cartel Office may dissolve a merger by issuing a cease-and-desist order within one year of registration or within four months, if the companies had registered voluntarily before the merger. As a practical matter, the threat of potential divestiture causes most companies engaged in a larger merger to register in advance with the Federal Cartel Office. Decisions by the Federal Cartel Office may be appealed in court. In addition, the Federal Economics Ministry may overrule a Federal Cartel Office finding if it feels the public interest of allowing the transaction outweighs the potential impediments to competition.

Although the Federal Cartel Office has the broadest powers of any similar agency among the member states of the European Community, it has been extremely restrained with respect to mergers and acquisitions in the new federal states. Up to May 1991, the Federal Cartel Office had only disapproved one out of approximately 700 such transactions that it reviewed.

b. EC Merger Controls

Articles 85 and 86 of the EC Treaty and the long-awaited EC merger control directive recently enacted in 1990 also became applicable

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484 GWB § 23(2).
485 Id.
486 Id. § 23(1).
487 Id. § 24(2).
488 Id. § 24(2).
489 See IL&T, supra note 9, at 10.
490 GWB § 62(1).
491 Id. §§ 24(2), (3). See also IL&T, supra note 9, at 9.
492 IL&T, supra note 9, at 6.
in the new federal states upon unification. The EC has made clear that these legal norms will be applied to the new federal states on a non-discriminatory basis, but that it does not rule out a more flexible approach than toward other EC regions during the general transitional period up to December 31, 1992. Under the EC merger directive, prior approval must be obtained from the EC Commission for mergers with an "EC dimension." Such mergers are intra-EC mergers between companies with combined worldwide sales of at least ECU 15 billion and with sales turnover of two of the participating companies within the European Community of at least ECU 250 million each, unless each such participating company has more than two-thirds of its EC sales turnover in the same EC member state. The nationality of the companies is irrelevant for this determination. The German Federal Cartel Office generally does not have jurisdiction over mergers with an "EC dimension." The German government may, however, request the European Community to refer the merger to the Federal Cartel Office, and the European Commission may alternatively be requested by the German government to review a merger without an EC dimension.

2. Government Subsidies

The EC Treaty generally prohibits subsidies which result in commercial restraints on competition between EC member states. Nevertheless, an exception to this general prohibition is provided for subsidies which are highly beneficial to the national interest of an EC member state, and the EC Commission is also given discretion to permit other subsidies when it deems necessary. Those EC member states establishing or expanding national subsidy or incentive programs typically must notify the EC Commission before undertaking such action. Although the EC Commission plans to constructively apply EC law with respect to state subsidies in the new federal states, it has also made clear that such application will have to continue to retain equal competitive conditions through the European Community, to maintain a "level playing field" within the common market, and to avoid any artificial or unjustified advantage for Eastern German companies vis-a-vis other companies.


See EC UNIFICATION BULLETIN, supra note 7, at 75.

Upon notification, the EC has a three-week period in which to undertake its review of the merger.

EC Treaty, art. 92(1).

Id. art. 92(2).

Id. art. 92(3).
Privatization has occurred and continues to occur in a number of EC member states, but the magnitude of the privatization overseen by the Treuhand in the new federal states is without precedent and has raised a number of EC competition law issues. The EC Commission is aware of the questionable financial status of most of the companies held by the Treuhand and is further aware that, without subsidized financing from the Treuhand, many of those companies would not be able to secure private financing. Mutually agreeing with the premise that preferential financing from the Treuhand is essential to the economic development of the new German federal states, the EC Commission and the German government reached agreement on September 18, 1991, regarding the activities of the Treuhand [hereinafter September Agreement].

The EC Commission acknowledged that the activities of the Treuhand are compatible with the EC Treaty, but nevertheless will monitor and expects to be notified of any subsidies granted by the Treuhand which have a material impact on the German economy. In addition, the German authorities are to provide the EC Commission with bi-annual reports beginning the end of 1991 outlining the activities of the Treuhand. Under the September Agreement, purchasers of companies sold by the Treuhand to the highest bidder through an open auction will not be deemed to have received a subsidy. Furthermore, debt written off by companies held by the Treuhand or liability assumed by the Treuhand for environmental damage existing before July 1990 will not be considered as a subsidy, whereas the granting of preferential credits and guarantees to such companies will be deemed a subsidy, although the EC Commission will look more favorably on such financing given the need for rapid economic development in the new federal states. 

Nevertheless, the EC Commission has indicated that a privatization strategy using public funds to discriminate against foreign investors, regardless of the regional economic situation, would not be condoned.

VI. CONCLUSION

The unification of the two Germanies has provided many intriguing business and investment opportunities in the new federal states for com-
panies and individuals wishing to engage in long-term investments rather than in short-term speculation. It will be interesting to see the rapidity with which the new federal states are brought up to speed and integrated into the German "Wirtschaftswunder." The volume of foreign investment into the new federal states in the coming months should play a substantial role in shaping their economic future.

Those interested in investing in the new federal states should carefully balance the pros and cons of such an investment. Obviously, an article of this length, or any article for that matter, cannot furnish the reader with all the information concerning an area the size and diversity of the five new federal states, which is required to make informed business or investment decisions, but should offer the reader the necessary background information needed to intelligently interface with local German counsel. As mentioned a number of times in this article, interested investors should seek professional advice which can prove to be invaluable in evaluating and implementing an investment in the new federal states.
APPENDIX A

UNIFIED GERMANY
**APPENDIX B**

**TREUHAND ORGANIZATIONAL STRUCTURE**

**BERLIN HEADQUARTERS**

**PRESIDENT**

**GENERAL RESPONSIBILITIES:**
Board of Directors, economic matters, business development, investor services, relations with federal and international relations, Bonn office, federal state matters, corporate planning, communication/media, legal issues, review and assessment of overall operations and performance, Amt zur Regelung offener Vermögensfragen

**BUSINESS SECTOR 1**

**BUSINESS RESPONSIBILITY:**
Construction of heavy machinery and industrial facilities, toolmaking machinery, specialty machinery

**FUNCTIONAL RESPONSIBILITY:**
Administration/controlling for held companies, review of business plans

**BUSINESS SECTOR 2**

**BUSINESS RESPONSIBILITY:**
Optics/ceramics/precision engineering, motor vehicle production, coastal industries, transportation

**FUNCTIONAL RESPONSIBILITY:**
Liquidation, reorganization

**BUSINESS SECTOR 3**

**BUSINESS RESPONSIBILITY:**
Agriculture and forestry, food and beverages, construction industry, misc. specialty goods, export businesses

**FUNCTIONAL RESPONSIBILITY:**
Administration, organization/EDP

**BUSINESS SECTOR 4**

**BUSINESS RESPONSIBILITY:**
Electrical engineering/electronics, timber/paper, services, oversight and coordination of 15 branch offices, Gesellschaft zur Privatisierung des Handels mbH

**FUNCTIONAL RESPONSIBILITY:**
Privatization

**BUSINESS SECTOR 5**

**BUSINESS RESPONSIBILITY:**
Iron and steel production, metal industry, hotels and catering, financial assets, Liegenschaftsgesellschaft der Treuhandanstalt mbH (TLG)

**FUNCTIONAL RESPONSIBILITY:**
Treuhand financing, environmental protection and cleanup

**BUSINESS SECTOR 6**

**BUSINESS RESPONSIBILITY:**
Public property, water resource management, energy management, chemicals, textiles/clothing/leather, limestone and ore mining, minerals chemicals, textiles/clothing/leather, limestone and ore mining, minerals

**FUNCTIONAL RESPONSIBILITY:**
Financial, business and tax planning, oversight of contractual negotiations, business finance/balance sheets, bank guarantees, accounting/budgeting

**BRANCH OFFICES (Federal State/City)**

Berlin
- Berlin

Mecklenburg-Vorpommern
- Schwerin
- Rostock
- Neubrandenburg
- Brandenburg

Sachsen-Anhalt
- Potsdam
- Frankfurt/Oder
- Cottbus

Sachsen
- Dresden
- Leipzig
- Chemnitz

Thüringen
- Erfurt
- Gera
- Suhl

**PERSONNEL**

**FUNCTIONAL RESPONSIBILITY:**
Treuhand staff, personnel of held companies, labor market and welfare matters, internal regulations and guidelines, pay and salary

**FINANCE**

**FUNCTIONAL RESPONSIBILITY:**
Financial, business and tax planning, oversight of contractual negotiations, business finance/balance sheets, bank guarantees, accounting/budgeting

A. INVESTMENT GRANTS
Federal investment grants:
12% of acquisition or production cost for movable depreciable assets where acquisition or production commences after June 30, 1990 and is completed before June 30, 1992. For qualified assets acquired or produced between June 30, 1990 and January 1, 1995, the percentage is reduced to 8%, provided that the assets have been ordered or put into production prior to January 1, 1993. Assets not eligible for investment grants are automobiles, airplanes, used assets, and assets whose value does not exceed DM 800. Qualifying assets must remain in the business for at least three years following their purchase or production and cannot be used more than 10% during this period for private purposes. The investment grant is tax-free and does not reduce the depreciation base.

Federal savings grants:
The federal government provides savings grants for those individuals, including foreigners, who are saving in order to establish a business in the new federal states. The savings grant amounts to the lesser or 20% of the amount saved or DM 10,000, and the savings period must be between three and ten years.

Local investment grants:
Local investment grants are available up to February 28, 1995. Qualifying assets may neither be land nor transportation vehicles, but unlike federal investment grants, may be assets which have already been utilized. They must remain in the business for at least three years or be replaced by an asset of the same or higher value. Investors must show that the planned investment can reasonably be expected to be profitable, that jobs are to be secured or created, and also that sales comprising more than 50% of production are to occur within thirty kilometers of the investment site. Grants may be obtained for up to 23% of initial or production costs for new business investments, up to 20% for expansion investments, and up to 15% for investments undertaken for rationalization purposes. Local investment grants are taxable and will either be taxed income in the year of investment or diminish the depreciation base. Such grants may be combined with federal investment grants, special depreciation allowances, and subsidized loans so long as they do not exceed a subsidy cap of 35% for the total investment.

B. LOANS
European Recovery Program:
Loans available for the creation of new businesses, modernization, and environmental protection. Such loans are long-term, below-market, and fixed-rate and are available up to a maximum amount of DM 1 million. Eligible recipients are individuals, small and medium-sized privately-held businesses, and professionals.

Investment Loans:
Available from the Deutsche Augleichsbank (German Equalization Bank) for interest subsidies and extensions of loans.

European Investment Bank:
Funds are available for infrastructure development, modernization and restructuring of industry, and small business investment projects serving EC interests. Loan maturities range from seven to twenty years at favorable rates.

Capital Investment Assistance Program:
To assist self-employed business establishments, reduced-interest loans are granted at zero interest during the first three years, 2% interest in the 4th year, 3% in the 5th year, and 5% in the 6th year. Recipients may be no older than fifty years of age and have proven technical and business qualifications, as far as these are required to carry out their respective businesses. Recipients must prove that without initial financial assistance the starting of the business would be made considerably more difficult and that the recipient can furnish or acquire additional capital requirements, which can be either cash or non-cash assets.

Reconstruction Credit Authority:
This is a form of investment assistance for small and medium-sized establishments. Special consideration is given to investments seeking to improve the environment. These loans are subsidized through reduced interest rates and repayment deferrals.

Truehand:
Former state-owned companies capable of reorganization are offered loan financing or guarantees at favorable terms.

Overseas Private Investment Corporation:
American investors may receive favorable loan financing, loan guarantees, and political risk insurance for investment projects in the new federal states.

C. GUARANTEES
Loan guarantees are available from the ERP, and the federal or state governments for certain investment purposes where loan financing could not otherwise be obtained. Federal, state and
private export credit guarantees are also available to cover economic, political, credit and similar risks. Additional guarantees are also provided against currency risks involving foreign exchange losses.

D. TAX-FREE RESERVES

Replacement of Assets:
A German business that realizes a capital gain upon the sale of qualifying fixed assets or real property may defer the tax on 50% (100% for land and buildings) of such gain, provided that the assets have been owned for a minimum of six years. The replacement asset must be acquired no later than four years after forming the reserve. Any reserve balance remaining at the end of this four-year period, plus an interest charge of 6% for each year of the reserve's existence, must be added back to taxable income.

Price Increases:
If the replacement cost of certain qualifying goods held by a business for processing or resale has increased by more than 10% during a fiscal year, a tax-free reserve may be established for the excess over such 10% increase.

Startup Losses:
A company with at least a 10% direct interest in a company with its registered office and principal place of business in one of the new federal states may form a tax-free reserve for any startup losses incurred in the first five years after initial share acquisition. The reserve must be added back to taxable income to the extent the subsidiary realizes a profit and no later than five years after its formation. The reserve may only be formed if the acquisition of shares in a company in the new federal states occurs before January 1, 1992.

Transfer of Depreciable Fixed Assets:
A taxpayer resident in Germany who recognizes gain upon the transfer of depreciable fixed assets to a company or permanent establishment in the new federal states in exchange for shares in such business entity may defer inclusion of such gain in taxable income by creating a tax-free reserve up to the amount of the difference between the market value and the book value of such transferred asset. Such reserve is to be added back to taxable income beginning at the latest in the tenth year following its formation at an annual rate of at least 10%. In order to qualify for such treatment, assets must be transferred to a subsidiary or permanent establishment in the new federal states before January 1, 1992.

E. SPECIAL DEPRECIATION ALLOWANCE

Small and medium-sized businesses:
Special depreciation allowances are available for small and medium-sized businesses doing business throughout Germany. Such businesses must have less than DM 240,000 in total assets and less than DM 500,000 in taxable business capital for municipal trade tax purposes. In conjunction with normally permissible depreciation, qualifying businesses may in addition depreciate up to 20% of an asset's acquisition or production cost in each of the first five years after acquisition or production. Total depreciation (i.e., special plus normal depreciation), however, may not exceed 100% of an asset's initial depreciation cost basis.

Movable or fixed assets:
Special depreciation allowances offered for investments in the new German federal states made after December 31, 1990 and completed before January 1, 1995. Qualifying assets must be depreciable movable or fixed assets. Those qualifying assets which are movable must remain in the company or permanent establishment located in the new federal states for a period of at least three years following purchase or production, and may be used no more than 10% for private purposes during this period. In conjunction with normally permissible depreciation and investment grants, a special depreciation of up to 50% of a qualifying asset's initial depreciation cost basis may be taken in the first five years after acquisition or production.

New construction, modernization or expansion of buildings:
Special depreciation allowances with largely the same benefits as for movable or fixed assets are also afforded investors who construct, or acquire within one year of construction, buildings in the new federal states, as well as to investors who undertake modernizations or expansion thereto. Such special depreciation applies, among other things, to rental apartments, one or more family homes, and warehouses or supermarkets which are privately owned and leased to businesses. Qualified investors must have a business presence in one of the new federal states. In addition to benefitting from a 50% special depreciation allowance over a five year period, qualified investors usually may also deduct the normal annual straightline depreciation of 2% which is applicable to buildings.

F. INDIRECT INCENTIVES:

Local governments are eligible through regional development programs for preferential financing in constructing among other things: (i) commercial and industrial facilities; (ii) transportation links to and from a commercial business; (iii) energy and water supply systems; and (iv) waste disposal and water treatment facilities.
APPENDIX D
INVESTMENT INCENTIVE SCENARIOS

1. Investment Plan of a Large Business

Total Investment: DM 100.0 million

Components:
- Equipment*: DM 70.0 million
- Buildings: DM 30.0 million

* Operating life of 10 years

Incentives and Tax Credits

- General Incentive (23%): DM 23.0 million
- Equipment Incentive (12%): DM 8.4 million

Special Depreciation:
- 50%*
- Straight Line Depreciation for Equipment 10%*
- Straight Line Depreciation for Building 4%*

* Basis for depreciation net of regional incentive paid

- Investment in equipment: DM 70.0 million
- Less 23% incentive: DM 16.1 million
- Basis for Assessment: DM 53.9 million
- Depreciation at 60%: DM 32.3 million
- Tax Saving at 50% Rate: DM 16.1 million

- Investment in buildings: DM 30.0 million
- Less 23% incentive: DM 6.9 million
- Basis for Assessment: DM 23.1 million
- Depreciation at 54%: DM 12.5 million
- Tax Saving at 50% Rate: DM 12.5 million

Total Incentives and Tax Savings: DM 53.7 million

Total first year incentives and tax relief amount to 53.7% of the amount invested; this exceeds the tax relief impact of an immediate 100% write-down, which would amount to DM 50 million, or 50%. It should be noted that non-tax benefits are currently capped at 35% of total investment due to a recent decision of the EC Commission.

2. Investment Plan of a Small or Medium-Sized Business

Total Investment: DM 1,000,000

Components:
- Equipment*: DM 700,000
- Buildings: DM 300,000

* Operating life of 10 years

Incentives and Tax Credits

- General Incentive (23%): DM 230,000
- Equipment Incentive (12%): DM 84,000

Special Depreciation:
- 50%*
- Straight Line Depreciation for Equipment 10%*
- Straight Line Depreciation for Building 4%*

* Basis for depreciation net of regional incentive paid

- Investment in equipment: DM 700,000
- Less 23%: DM 161,000
- Basis for Assessment: DM 539,000
- Depreciation at 60%: DM 323,000
- Tax Saving at 35% Rate: DM 113,200

- Investment in buildings: DM 300,000
- Less 23%: DM 69,000
- Basis for Assessment: DM 231,000
- Depreciation at 54%: DM 124,700
- Tax Saving at 35% Rate: DM 43,700

Total Incentives and Tax Savings: DM 470,800

Including exemption from the solidarity surtax, total first year incentives and tax relief amount to approximately 47% of the investment; this exceeds the tax relief impact of an immediate 100% write-down which would amount to DM 350,000, or 35%. It should be noted that non-tax benefits are currently capped at 35% of total investment due to a recent decision of the EC Commission.