The Liberalization of the German Health Care Service Sector

The introduction of the medical ambulatory service center has changed Germany’s health care industry in ways not seen since 2003. Prior to 2004, only physicians working in their sole local offices or in local partnerships could provide ambulatory medical services. However, effective in 2004, a new form of ambulatory medical service provider was introduced: the Medizinische Versorgungszentren, medical ambulatory service center, or MVZ. An MVZ may be owned by anyone having any license within the public health care system, and this license is not very difficult to obtain. For example, all a company has to do is sell wheelchairs or similar products to apply for a license, and, as a result, an investor in such company may become the beneficial owner of an MVZ.

Panel Physicians Amendment Act

On January 1, 2007, the Panel Physicians Amendment Act (Vertragsarztrechtsänderungsgesetz or VÄndG) came into force, further advancing the deregulation of the ambulatory health care service sector in Germany. Until 2006, a license to provide ambulatory medical services only entitled its bearer to do so at a certain location. Physicians and MVZs were not allowed to apply for two licenses in two different locations. Following the enactment of the VÄndG, MVZs and groups of physicians may now open branches and provide services in various regions and— theoretically—all over Germany.

However, a system of determination of need (Bedarfsplanung) still limits this possibility. According to Bedarfsplanung, regulatory health care bodies may decide that in certain areas a “market” need for general practitioners or physicians of certain specializations does not exist and that further applications will be rejected. In this case, any new applicant—he it a physician or an MVZ—has to buy a license from a retiring physician with comparable qualifications. According to the government’s current plans, however, the entire system of determination of need may be abolished within the next two years.

MVZ Business Models

The MVZ not only enables investors to enter the ambulatory medical market, it also significantly eases the strict separation between inpatient and outpatient services. Traditionally, German hospitals were—except for cases of urgencies—not allowed to provide outpatient services to the vast majority of the population, i.e., the publicly insured. This changed in 2004 when hospitals could legally own an MVZ, thereby entering the outpatient sector. Until 2006, however, hospitals were largely not allowed to employ physicians who provided both inpatient services in the hospital and outpatient services in the MVZ. Rather, employed physicians could only work in one or the other. The VÄndG has abolished this inconvenient prohibition.

To enter the outpatient sector, hospitals generally tend to establish MVZs through wholly owned subsidiaries. Because this practice often provokes the resistance of their new competitors, i.e., physicians working in private offices, some hospitals prefer to enter joint ventures with leading entrepreneurial physicians.

This model appears more promising—in particular, one can look at the U.S. experience and the failures of physician practice management organizations (PPMs) versus the successes of ambulatory service centers (ASCs). PPMs were providers of outpatient services that were solely owned and run by investors who had previously purchased the physicians’ offices and employed those physicians. Many of those PPMs became insolvent because the physicians did not have sufficient incentive to generate wealth for the company. ASCs, however, are an...
entirely different story. Most of them are highly profitable, and some of their providers are publicly listed. ASCs are usually run by management companies who also hold shares in the ASCs—albeit with physicians as co-shareholders.

**Conclusion**

Germany’s health care service system has been opened up to new investment and structuring opportunities. While they may seem commonplace to anyone familiar with the U.S. health care system, in Germany such structures would have been unthinkable only a few years ago.

In its deregulation plans, the German government is pursuing its objective to increase competition among various health care service providers and to realize greater synergies across the industry. While this has been the case for hospitals and nursing homes for quite some time, the German health care service sector has finally nailed its intentions for the ambulatory and outpatient sector to the door—private investments are wanted.

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**German Cabinet Approves Corporate Tax Plan 2008**

On May 25, 2007, the German Parliament approved a draft corporate tax plan (enterprise tax reform), which is scheduled to become effective on January 1, 2008. The reform seeks to create a more competitive tax environment for companies by reducing the nominal tax rates, avoiding the (further) erosion of the tax base in Germany by limiting in particular the amount of interest companies can deduct from their taxable income, and limiting the use of loss carry-forwards by significantly tightening the change of control rules. It is very likely that the new law will be implemented. The second chamber of the Parliament still has to approve the tax plan. A final decision is planned on July 20, 2007.

Notwithstanding the reduction of the tax rates, U.S. investors likely will find that the limitation of the deduction of interest will result in a notably higher effective tax burden on leveraged financing structures in Germany.

**Reduction of Nominal Tax Rates**

The draft bills provide a reduction of the average tax burden for corporations from 38.65 per cent to 29.83 per cent, consisting of a corporate tax of 15 per cent (currently 25 per cent), a solidarity surcharge of 0.83 per cent (5.5 per cent of the corporate tax) and an average trade tax of 14 per cent, depending on the tax rate of the local community.

**Limitation of Interest Deduction for Corporate Tax**

For corporate income tax purposes, lawmakers have proposed that an interest surplus is only deductible up to 30 per cent of the taxable earnings before interest, taxes, depreciation and amortization (EBITDA). Interest surplus means the difference between interest expenses and interest income. The exceeding interest surplus can be carried forward to later fiscal years and can be deducted in these years under the same prerequisites. The current thin-cap rules for shareholder loans will be abolished. There are three exceptions to this limitation:

**€1 Million Exemption Limit**

Interest expenses are fully deductible if the interest surplus of the corporation falls below €1 million. If the interest surplus just hits the €1 million threshold, the entire surplus is only deductible under the general rule described above.

**No-Group Clause**

The limitation clause only applies if the corporation seeking the deduction of interest belongs to a group of companies. It is currently uncertain whether private equity funds or a master Luxembourg S.A.R.L. would qualify as head of a group. However, this “no-group exception” is only applicable if there are no harmful shareholder loans. In the case of harmful shareholder loans, the limitation for all (not only shareholder loans) interest expenses will be applicable if interest on shareholder loans exceeds 10 per cent of the interest surplus (interest expenses/interest income) and the shareholder loans are owed to a shareholder with a minimum participation of 25 percent, to a related party to these shareholders, or to third parties who can recourse against such a shareholder or a related party. In contrary to the current thin-cap rules, a recourse right is already assumed if the third party has a pure legal recourse right.

**Sufficient Equity/Debt Ratio**

If the no-group clause is not applicable, the general limitation rule can only be avoided if the equity/debt ratio of the German corporation is not lower than the overall equity/debt ratio of the entire group to which the corporation belongs (the so-called escape clause). According to the draft bill, only a shortfall of 1 percent will be accepted. The relevant ratio will be mainly determined according to international financial reporting standards (IFRS). Comparable to the “no-group clause,” the escape clause is only applicable if there are no harmful shareholder loans. The prerequisites of a harmful shareholder loan granted by a person not belonging to the group are basically the same as under the “no-group clause.” However, there are two crucial differences:
A shareholder loan is “harmful” if 10 percent of the interest payments on shareholder loans are already harmful, regardless of the entire group’s seat or place of management, not only on shareholder loans granted to the German entity actually seeking the interest deduction.

The re-exception for the shareholder loans does not apply to shareholder loans that are consolidated in the balance sheets of the groups.

No Grandfathering Rules for Established Structures

As there are no grandfathering rules provided for the new regime, it would not only have immense impact on the structuring of newly set-up leveraged transactions but on established structures as well. With regard to those structures, an application of the current thin-cap rules on third-party loans is very often avoided by using the present narrower understanding of a recourse loan, which is basically only assumed in a back-to-back financing structure.

Limitation of Deduction of Financing Parts of Payments for Trade Tax

For trade tax purposes, there are additional rules that provide for a supplemental limitation of the deduction of interest and a fictive “financial part” of leases, rent and royalties. Interest not deducted for corporate income tax purposes remains fully non-deductible for trade tax purposes, too. Additionally, for trade tax purposes:

- 25 percent of interest payments that include payments to a silent partner (note that under current law 50 percent of the interest is non-deductible provided they are made for long-term financing)
- 18.75 percent of rent and lease payments on immovable assets such as property
- 6.25 percent of rent and lease payments on movable assets and of royalties under a license agreement

cannot be deducted. There is only a tax free amount of €100,000. The non-deductible part cannot be carried forward.

Use of Loss Carry-forward after a Change in Control

According to the draft bill, the use of a loss carry-forward after the acquisition of the shares in a German corporation will be significantly tightened. A utilization of the loss carry-forward is restricted if there is a direct or indirect chance in ownership within five years:

- If more than 25 percent, but not more than 50 percent of the shares are transferred within five years, the loss carry-forward cannot be utilized at the rate the ownership has changed.
- If more than 50 percent are transferred within five years, the use of the loss carry-forward is entirely banned.

An interest carry-forward will be fully or partially lost under the same prerequisites.

New German Telemedia Legislation Clarifies Some Issues; Clouds Others

The new German Telemedia Act (Telemediengesetz or TMG) and the Ninth Amendment of the Interstate Treaty on Broadcasting (Rundfunkstaatsvertrag or RStV) went into effect on March 1, 2007. The TMG replaces the Teleservices Act (Teledienstegesetz or TDG), the Teleservices Data Protection Act (Teledienstedatenschutzgesetz or TDDSG) and the Interstate Treaty on Media Services (Mediendienstestaatsvertrag or MDStV) and provides the new legal framework for electronic information and communication services in Germany. The e-business community should be glad to know the new act provides for greater legal certainty for providers of electronic services in Germany. However, the TMG also leaves a number of issues unresolved.

Previous Regulation of Electronic Services in Germany

Prior to the creation of this uniform law, e-information and e-communications providers had to refer to a number of different statutes to identify the relevant legal requirements governing their offerings. Electronic services were primarily governed by the Teleservices Act, the Teleservices Data Protection Act (both covering teleservices), the Interstate Treaty on Media Services (Mediendienstestaatsvertrag or MDStV) and the Interstate Treaty on Broadcasting (covering nationwide audio and television broadcasting) and the Telecommunications Act (Telekommunikationsgesetz or TKG, covering telecommunications services).

Before a provider could even determine which of these regulations applied, it had to determine whether its service was categorized as a teleservice, media service, telecommunications service or broadcasting. However, the distinction between these categories was often complex or even impossible to determine.
For example, legal scholars and courts have vigorously debated the proper qualification of internet access, e-mail services, internet protocol television (IPTV), voice-over-IP (VoIP), video-on-demand (VoD) and mobile television service providers ever since these services have emerged without—as yet—a satisfying result. As a consequence, providers of electronic services have often felt constrained to comply with the strictest requirements in order to avoid sanctions from regulatory authorities or from competitors. To address at least some of these problems, the German legislature decided to reform the laws governing electronic services, which led to the enactment of the TMG.

Teleservices and Media Services Merge to Become Telemedia

The main objective of the Telemedia Act is to mitigate the problems surrounding the classification of electronic services and to provide a uniform legal framework covering the various electronic information and communication offerings. To achieve this objective, the Telemedia Act abandons the former distinction between teleservices and media services. Instead, the act now defines all electronic information and communication services (with the exception of telecommunication services consisting entirely of signal distribution via telecommunications networks and broadcasting) as telemedia. It also states that value-added services (defined in section 3 number 25 of the TKG) do not fall within the definition of telemedia and are governed exclusively by the TKG.

Legislators have further clarified the classifications of formerly disputed services. As a general rule, services that have previously been classified as teleservices or as media services now fall under the definition of telemedia. This applies, for example, to online shopping, online newspapers and newsletters, search engines, video-on-demand services, and the distribution of advertising e-mails. Voice-over-IP, on the other hand, constitutes mere telecommunication and, therefore, falls outside the scope of the TMG.

Under previous law, some courts qualified VoIP as a teleservice or media service, arguing that voice transmission via internet protocol was not possible in real time and should therefore be treated differently from conventional telephony. In the light of recent technical developments, legislators disagreed with this opinion and decided that VoIP should not be treated differently than conventional telephony. Live streaming and/or web-casting of conventional television or audio programs also falls outside the scope of the TMG, as it constitutes broadcasting within the definition of the Interstate Treaty on Broadcasting. The legislators stressed the distinction between teleservices and broadcasting does not depend on the technical means of signal distribution (satellite, cable, terrestrial or internet/DSL) but on the relevance of the content for the forming of opinions (Meinungsbildungsrelevanz). So far, it seems the TMG has undoubtedly led to a higher degree of legal certainty for electronic information and communications services providers.

Unresolved Issues and Future Prospects

However, the new Telemadia Act leaves a number of important issues unresolved. Providers still have to distinguish between telemadia (covered by the TMG), telecommunication (covered by the TKG) and broadcasting (covered by the Interstate Treaty on Broadcasting). The new section 20 paragraph 2 of the RStV causes even more confusion. It seems to imply that certain electronic information and communication services that do not constitute broadcasting within the meaning of the RStV may in fact be “associated” with broadcasting, meaning that providers of such services would have to obtain a broadcasting license according to German state law. Moreover, the newly amended Interstate Treaty on Broadcasting now contains special provisions for “telemedia with journalistic and editorial content,” which are basically the same services formerly known as “media services.”

As a consequence, the ostensibly abandoned differentiation between teleservices and media services may still remain an issue, albeit in a new outfit.

Further Reform?

Unfortunately, the TMG makes practically no changes to the content of the law but simply adopts previous regulations from the TDG and TDDSG to a large extent, even though legislators acknowledge that there is an urgent need for substantial changes, e.g., to the provisions on service providers’ responsibilities. Some observers expect that the new TMG will have only a short lifespan and German telemedia law will again be subject to reform within the next few years.

Squeeze-Outs in Germany: Becoming Stale for Hedge Funds?

In the past, hedge funds have profited from investing in listed German companies going through a corporate restructuring, particularly those in the midst of a squeeze-out. These investments were attractive because, under the German Stock Corporation Act (Aktiengesetz or AktG), shareholders of German stock corporations are entitled to receive a “fair compensation” for their shares in case of corporate reorganization measures, such as a squeeze-out or the conclusion of a domination and profit-loss
pooling agreement (Beherrschungs-und Gewinnabführungsvertrag) with a holding company after a takeover. However, two recent court decisions may signal an end to these profitable opportunities.

**Maximizing Compensation**

Such mandatory compensation situations are the arbitrageur’s ideal opportunity because compensation is based on one of two factors—one fixed and one flexible. Hedge funds and other minority investors have found opportunity between these two factors. In the first “fixed” case, mandatory compensation is based on the company value as of the date of the shareholders’ meeting at which the corporate measure is approved. Value is determined by a chartered accountant in the net earnings method (Ertragswertverfahren) and in accordance with the Standard IDW S1.

In the second “flexible” case, compensation is based on average share price over a three-month period. The German Federal Supreme Court (Bundesgerichtshof) decided in its March 2001 DAT/Altana decision that compensation may not fall short of a three-months average share price if a share price of the relevant company exists. Final compensation is based on the higher of the two factors.

Hedge funds and other minority shareholders liked to invest in these restructuring companies because they could manipulate average share prices to their advantage. According to the DAT/Altana decision, the average share price had to be calculated over a three-month period prior to the relevant shareholders’ meeting. Because the company has to publish its intent to restructure immediately after making that decision (in general several months prior to the shareholders’ meeting), minority shareholders had enough time to acquire shares in the company and then to push the average share price up until it exceeded the company’s value on the date of the announcement, thus ensuring higher mandatory compensation.

Although legal scholars highlighted the flaws in this process, most courts continued to follow the DAT/Altana decision.

**Two Court Decisions Affect Compensation**

Two higher courts recently took a different view regarding the determination of the average share price, one that is opposite to the Federal Supreme Court’s DAT/Altana decision. In late 2006, the Berlin High Court (Kammergericht) ruled that the relevant end date for the three-month average share price should be the date of the announcement and not the date of the shareholders’ meeting. This means that the average share price relevant for the compensation is already determined in the moment of the announcement of the corporate measure. Any trading and development of the share price after the announcement would be irrelevant for the compensation derived from the average share price. In February 2007, the High Court (Oberlandesgericht) in Stuttgart took the same position.

Although contrary to the DAT/Altana ruling of the Federal Supreme Court, both decisions are not surprising. German legal scholars had already pointed out the flaws of the Federal Supreme Court’s ruling. For example, in the case of a squeeze-out the major shareholder must submit a report on the fairness of the compensation, which it then has to include in the invitation to the shareholders’ meeting. However, the Federal Supreme Court decision made it impossible for the major shareholder to report on the fairness of the compensation prior to the shareholders’ meeting as such compensation could only be determined on the day of the shareholders’ meeting. In addition, the application of the three-month period prior to the shareholders’ meeting made it easy for arbitrageurs to push the share price and therefore the compensation to a higher level, which probably did not accurately reflect the company’s value. Finally, critics argued with a comparison to the relevant offer regulation (Angebotsverordnung) of the German Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz or WpÜG), which says that in takeover offers, the average share price over the course of three months prior to the date of the announcement of the decision to launch a tender offer determines compensation.

Because it deviated from the DAT/Altana ruling, the High Court Stuttgart submitted its ruling for a final decision to the Federal Supreme Court. If it keeps the above arguments in mind, the Federal Supreme Court very well might overrule the principles set forth in the DAT/Altana decision.

Hedge funds might not find German-listed companies to be the profitable investments they once were. If the Federal Supreme Court agrees that the average share price should be determined the moment the corporate measure is announced, then hedge funds lose their ability to alter share price and to generate a higher return.

**McDermott News from Germany**

McDermott was recently recognized in Chambers Europe 2007. In private equity: venture capital, our Firm was ranked in the second tier, and Martin Kock was named to the first tier and as leading in the field. McDermott was also ranked in tax, and Dirk Pohl was named leading in his field. In the category of TMT: media, the Firm was ranked in the second tier, Wolfgang von
Frentz was named to the second tier and Ralf Weisser was named to the first tier as leading in the field.

Our Düsseldorf office recently welcomed Dr. Stefan Fink to the Firm. As a partner in the Corporate Department and member of the Real Estate Group, he advises clients on all aspects of corporate real estate law, including real estate transactions, real estate transaction finance, real estate outsourcing, commercial tenancy law, public and private construction law and project development. He represents U.S. and European investment funds and investment banks as well as further real estate investors and project developers. His experience adds to the extensive capabilities of our German real estate team in complex cross-border real estate portfolio transactions.

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