McDermott Will & Emery

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IN

International News

FOCUS ON

Real Estate

Germany: The New Hub of Europe's Real Estate Market

Pitfalls to Avoid When Acquiring French Vineyards

FinCen Takes Aim at Real Estate Secrecy in Manhattan and Miami

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International News

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Market participants are optimistic about the European real estate market and no country is more buoyant than Germany. According to a PWC survey, Emerging Trends in Real Estate Europe 2015, four German cities are among the top 10 most active real estate markets in Europe. Our cover story looks at the trends that make the German market ripe for national and foreign investment.

The US real estate market has seen some significant developments. In Manhattan and Miami-Dade, a trial launched by the US Department of the Treasury requires the disclosure of the natural persons behind companies used to pay for "all-cash" US$ million residential real estate. The requirement is intended to combat money laundering in the real estate sector.

In our Features section, we take a look at how to select a trade mark to better build your brand, and examine how the European Commission can correct errors in successfully challenged decisions to replace the annulled decision with one likely to be upheld.

Please contact me if you have any comments on our articles or would like to discuss any of the issues raised.

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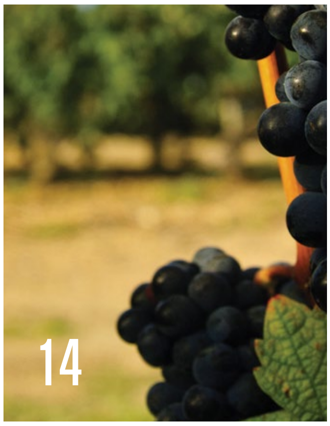

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New UK Requirement to Publish Annual Slavery and Human Trafficking Statement

ELEANOR WEST AND PAUL McGRATH

The United Kingdom's Modern Slavery Act 2015 requires large commercial organisations operating in the United Kingdom to publish a "slavery and human trafficking statement" at the end of each financial year. CONTINUED >

The requirement is intended to increase transparency and, in turn, accountability, by ensuring that the public, consumers, employees and investors know what steps an organisation is taking to tackle modern slavery, in both its own organisation and its supply chain. The UK Government believes that this will drive up standards amongst commercial organisations with significant resources and purchasing power, that are in a strong position to influence global supply chains.

The first organisations that will need to produce a statement are those with a financial year that ended on or after 31 March 2016. The UK Government expects affected organisations to publish the necessary statement within six months of the end of their relevant financial year.

> The statement will need to be approved by the highest level of management.

MODERN SLAVERY

The term "modern slavery" as used in the legislation is intended to refer to slavery, servitude, forced or compulsory labour and human trafficking. It includes any behaviour by an organisation that deprives a person of their freedom; exacts involuntary work or service, including under threat of penalty; and arranging or facilitating the travel of a person with a view to their being exploited.

AFFECTED ORGANISATIONS

All commercial organisations in any part of a group structure (wherever incorporated and whether a company or a partnership) will need to publish a statement if they carry on a business, or part of a business, supplying goods or services in any sector in the United Kingdom, and have an annual turnover of at least £36 million, after deduction of trade discounts, VAT and any other relevant taxes. This threshold includes the turnover of any subsidiary undertakings of the entity carrying on a business in the United Kingdom, regardless of where those subsidiaries are themselves incorporated or operating.

Any entity satisfying these criteria will be caught by the obligation, notwithstanding that it may be incorporated or formed outside the United Kingdom and irrespective of the purpose of the business. The extra-jurisdictional effect of the legislation means that all companies with operations in the United Kingdom and those conducting business internationally should take the time to carefully consider whether or not they are captured by the Act.

Ultimately, the UK courts will be the final arbiter as to whether or not an organisation carries on a business in the United Kingdom for these purposes, but it is clear from UK Government guidance that the new obligation is intended to apply broadly and that a common sense approach is envisaged. In practical terms, what will be required for the obligation to apply to an organisation is whether or not it has a demonstrable business presence in the United Kingdom. Having a UK subsidiary will not, in itself, therefore mean that a parent company is carrying on a business in the United Kingdom, provided the UK subsidiary acts sufficiently independently of the overseas parent company.

STATEMENT CONTENT

The statement must either specify the steps that the organisation has taken during the financial year to ensure that slavery and human trafficking is not taking place in any part of its own business or in its supply chains, or specify that the organisation has taken no such steps, which is unlikely to be considered an attractive option.

There are no other mandatory requirements about what the statement should contain or how it should be presented. Whilst compliance does not turn on how well statements are written, it is expected that they will be clear, detailed and informative, setting out all the steps the organisation has taken and be built on year on year. Statements will be read by the general public, investors and commentators and should therefore be carefully prepared with this audience borne in mind.

The types of information that are anticipated to be in a statement include

- Details of the organisation's structure, business and supply chains
- Any policies in relation to slavery and human trafficking
- A description of the due diligence processes the organisation follows in relation to assessing potential slavery and human trafficking in its business and supply chains
- The parts of the organisation's business where there is considered to be a risk of slavery and human trafficking, and the steps taken to assess and manage that risk
- An assessment of the effectiveness of any steps taken to ensure that slavery and human trafficking are not taking place
- Training provided to staff on these issues.

APPROVAL AND PUBLICATION

The statement will need to be approved by the highest level of management. For companies, this will entail approval by the board and signature by a director. For limited liability partnerships, the statement will need to be approved by the members and signed by a designated member.

Once finalised, the statement must be published on the organisation's website and a link to it, which UK Government guidance recommends be labelled "Modern Slavery Act Transparency Statement", should be included in a prominent place on its home page.

GROUP COMPLIANCE

Where multiple entities in a group are captured by the new obligation, it will be acceptable for a parent company to produce a single, consolidated statement that sets out the steps that each entity has taken, or that no steps have been taken.

> "Statements will be read by the general public, investors and commentators."

COMPLIANCE RISKS

Ultimately, the regime imposes no obligation on organisations to guarantee that their business or supply chain are free of modern slavery. The only legal obligation is for relevant organisations to produce the annual statement, but there is no direct legal sanction for an organisation that fails to produce one. In theory, the UK Secretary of State could seek a High Court injunction requiring the organisation to comply. Failure to do so would then be considered contempt of court, punishable by an unlimited fine, but injunctions are likely to be rare.

In practice, consistent with the UK Government's aim of creating a race to the top, the biggest incentive for encouraging compliance is likely to be reputational enhancement resulting from an impressive statement, *versus* the potential for reputational damage for failing to produce one. In this regard, the UK Government has indicated that it will be for consumers, investors and non-governmental organisations to engage and/or apply pressure where they believe a business has not taken sufficient steps.

PRACTICAL STEPS

There are a number of steps that organisations which may be captured by the regime should consider taking now:

> Identify which group entities (if any) may be captured by the new requirement and when.

> Consider the practicalities of how the organisation might go about producing a slavery and human trafficking statement, including which team internally will be responsible for its production.

> Conduct a risk assessment to identify any potential country, sector or transaction where there may be particular risks of modern slavery, whether within the organisation's own business or its supply chain.

> Review any control mechanisms already in place to manage those risks, including compliance policies, supply chain/procurement relationships and contractual provisions.

> Consider what additional steps and controls might be put in place.

It has long been the case that organisations operating in high risk sectors actively promote and exercise ethical business practices. For those organisations, the task of preparing a statement should be relatively simple and straightforward. The Act seeks to encourage this behaviour across the board, and organisations without any formal business practices should focus on demonstrating how they plan to instigate risk assessment and control to effect change.

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Selecting and Protecting International Trade Marks

JENNIFER MIKULINA AND SARAH BRO

The right trade mark can be an important asset that generates goodwill and adds tangible value to a product, service or real property.

When developing a brand and selecting a trade mark, it is important to enlist the assistance of an internationally-focused trade mark lawyer to assess whether or not the proposed name is available for use and registration, and to identify any third party risks associated with such use in the relevant jurisdiction.

In most countries, obtaining a trade mark registration for a new name provides a number of benefits, which may include

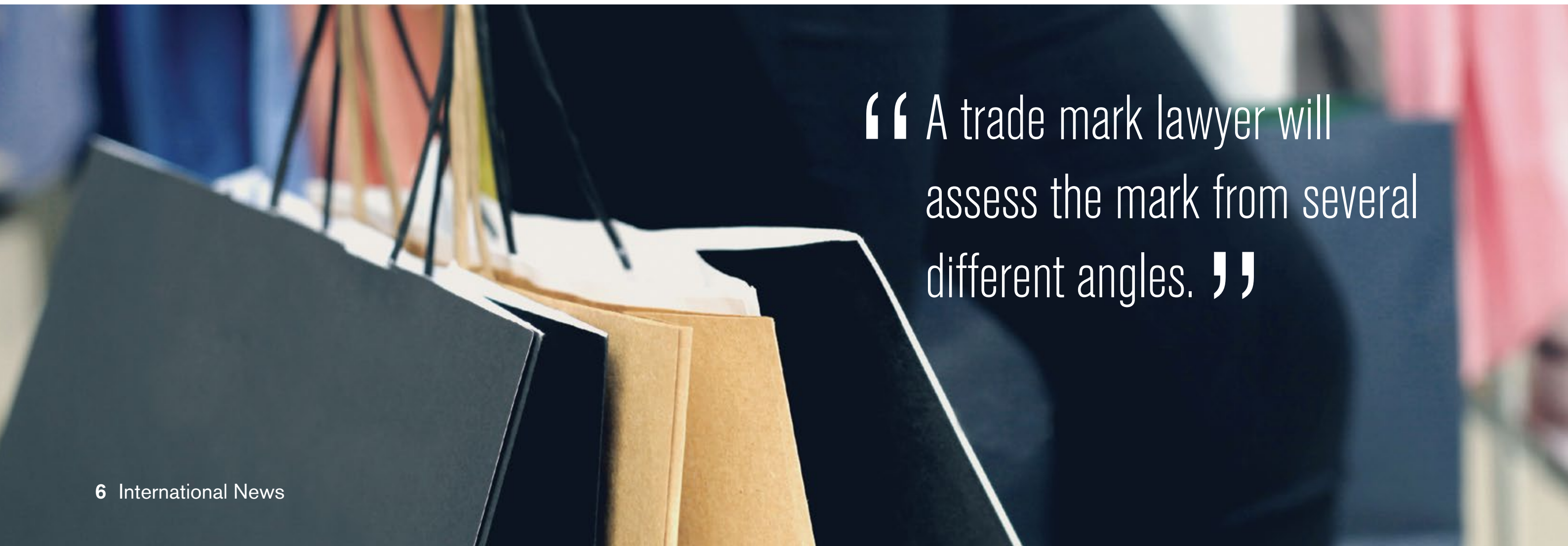
- Public notice of the registrant's ownership claim
- A legal presumption of ownership and the exclusive right to use the mark (in a given country or region) on, or in connection with, the goods/services listed in the registration, including property management services
- The ability to bring an action concerning the mark in an applicable court
- Use of the registration as a basis to obtain registration in other foreign countries
- Use of the registration as a basis for certain domain name registration challenges
- The ability to record the registration with the applicable customs office to prevent importation of infringing goods
- The right to use the registration symbol (®).

These benefits may differ by jurisdiction, again highlighting the need to consult with international trade mark counsel. When evaluating a proposed trade mark, to determine if it may be available for use and registration in a jurisdiction, a trade mark lawyer will assess the mark from several different angles.

EVALUATING THE STRENGTH OF A TRADE MARK

One primary consideration in assessing a proposed trade mark is its strength. When a mark is distinctive, it is often considered to be quite strong and entitled to broad protection. In the United States and many other jurisdictions, trade marks are categorised along a distinctiveness spectrum, and even those jurisdictions that undertake an analogous analysis will use a similar distinctiveness assessment:

- **Fanciful marks** are invented/coined terms that have no meaning other than as a trade mark, and are typically afforded broad protection. VDARA, as used in connection with a hotel in Las Vegas, is an example of a fanciful trade mark.
- **Arbitrary marks** are existing words that are unrelated to the applicable goods or services. Arbitrary marks are also considered to have a rather broad scope of protection. PENINSULA, as used in connection with hotels, is an example of an arbitrary trade mark.
- **Suggestive marks** allude to the applicable goods or services without directly describing them. Suggestive marks are weaker than fanciful or arbitrary marks, and can sometimes be difficult to enforce against third parties. SAND HILLS, as used in connection with a golf course, is an example of a suggestive mark.



"A trade mark lawyer will assess the mark from several different angles."

> **Merely descriptive** marks immediately describe the goods or services, or communicate a feature or characteristic of the goods or services. Laudatory terms such as “best” or “grand” are often classified as descriptive.

Absent a showing of acquired distinctiveness through continuous and exclusive use of a mark, “merely descriptive” marks generally are not entitled to trade mark protection. For example, CENTRAL TOWN MALL likely would be “merely descriptive” of a centrally located shopping mall. Conversely, and despite its arguably descriptive nature, MALL OF AMERICA has achieved registration in the United States, as the trade mark owner has demonstrated acquired distinctiveness of the mark due to its exclusive, long-term use and extensive consumer recognition

> **Generic terms** are the known meaning of a word or phrase, and are not entitled to trade mark protection. For example, “art museum” on its own is not registrable as a trade mark for an art museum, and Hotel Chicago is not registrable as a trade mark for a hotel in Chicago.

Geographically Descriptive Marks

It is common to select trade marks that relate to a property location or environmental surroundings. Unfortunately, however, these types of marks may be refused registration if they are considered to be geographically descriptive (or misdescriptive).

In the United States, Europe and other jurisdictions around the world, a trade mark may also be refused registration if it describes the geographic location in which the goods or services originate, or if the mark misrepresents the geographic location from which the goods or services originate. For example, NAPA VALLEY WINERY for a winery located in Napa County, California would be a “geographically descriptive” trade mark, while CHAMPAGNE WINERY in California likely would be a “geographically misdescriptive” trade mark, as champagne originates from the Champagne region of France, not California.

Once a trade mark lawyer has determined that the proposed mark is sufficiently distinctive, the next step is to assess the risk of a third-party challenge or registration refusal based on the existence of a prior, confusingly similar, trade mark.

TRADE MARK CLEARANCE SEARCHES

Initial Screening

A prior application or registration for a mark that is identical to the proposed name may prevent use of the name. A preliminary search will determine if it is necessary to go back to the drawing board at an early stage, when there is still time to develop and run searches for alternative names. Trade mark counsel can quickly conduct and review an initial trade mark “knock-out” or “screening” search of the relevant trade mark office database to see if any registrations or pending applications exist for marks that are identical to the proposed name(s).

Because some countries, such as Australia, India and the United States, recognise “common law” rights in unregistered trade marks that are in use, quick internet searches are also helpful for identifying third parties that may have priority in a particular name without a registration.

COMPREHENSIVE TRADE MARK SEARCH

If the results of a screening search are clear, the next step is to review a comprehensive trade mark search report, which will provide a better assessment of whether or not

> The proposed name is available for use

> Potential third-party challenges might arise

> Potential obstacles to registration exist.

A comprehensive trade mark search report includes references from the relevant country’s trade mark database, as well as references to common law marks and business names because, as noted above, unregistered marks can sometimes pose a risk in the geographic area in which the owner operates.

Reviewing a comprehensive search report gives a property owner or operator a stronger basis to assess the risk associated with the use and registration of a proposed mark.

A lawyer will also consider whether or not a likelihood of confusion will exist between the proposed mark and prior marks. Likelihood of confusion is the basis for trade mark infringement, so lawyers reviewing search reports typically consider variations of the likelihood of confusion factors used by the courts, such as the similarity in sight, sound, and meaning between the marks and the respective goods or services, and the similarity between the distribution, advertising and marketing channels through which the goods or services are offered, as well as other factors.

No search is perfect, and there is always a risk that a third party will claim it has prior rights in a trade mark, but following these steps should provide enough information to make an educated business decision about the viability of a proposed name and the potential third-party risk involved.

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ITALY > PRIVATISATION

New Italian Privatisation Rules on Publicly-Owned Companies

MARCO CERRITELLI AND VALENTINA PERRONE

After much debate, and the positive outcome of sales of publicly-held assets in 2015, the Italian Government is close to enacting a legislative decree to consolidate in one instrument the regulations applicable to publicly-owned enterprises.

The decree is expected to become one of the main pillars of the Government's privatisation policy, which was recently confirmed in the budget law.

Revenue arising from the privatisation or disposal of publicly owned assets in 2015 amounted to 0.4 per cent of Italy's gross domestic product (GDP). Divestments in the pipeline for the period 2016 to 2018 are estimated to collect further revenue in the amount of 0.5 per cent of GDP. By law, revenue generated from sales of shares that were directly held by the Italian Government must be used to reduce the public debt.

The new decree will be enacted in accordance with Law no. 124/2015 (the Spending Review Law) and is one of the 11 decrees with which the Italian Government intends to reform the entire Italian public administration system.

The decree provides, *inter alia*, for new privatisation rules that will apply to publicly-owned companies with the aim of facilitating the consolidation of the Italian public-sector market and opening the market to foreign players and financial investors.

PURPOSES AND LIMITS OF PUBLICLY-OWNED COMPANIES UNDER THE NEW FRAMEWORK

Article 4 of the new decree sets forth the main purposes that a public administrative body should fulfill through the purchase and the management of publicly-held companies. It also notes that an administrative body cannot establish, or directly or indirectly own, companies whose purpose is the production of goods or supply of services that are not strictly necessary to fulfill the administrative body's institutional purpose, nor purchase or hold interests (even minority interests) in such companies.

An administrative body can only establish companies and purchase or maintain interests in companies that provide the following:

- Management of services of public/general relevance, such as local public services
- Construction and operation of public works that form elements of programmes developed by public entities
- Construction and operation of public works or services under a public-private partnership between an administrative body and a private investor, which will be selected according to the rules relating to the selection of a private partner for the construction of public works

- Production (*autoproduzione*) of goods or services necessary for the purposes of the administrative body according to the provisions set forth by the European Directives and Italian laws in relation to public contracts
- Contracting services (*servizi di committenza*) that support nonprofit entities and public contracting entities (*centrali di committenza*) according to the Italian Code of Public Contracts.

Article 5 of the new decree states that the deed of incorporation of any company wholly or partly owned by an administrative body must confirm that one or more of the company's purposes are among those indicated in Article 4, and the reasons behind the administrative body's decision to hold an interest in that company. The administrative body must also highlight the economic benefits and the financial sustainability of its interests in the company, taking into account any alternative use of public resources.

The deed of incorporation must also make clear the consistency of the administrative body's choice to hold an interest in the company with the principle of administrative economic efficiency as laid out in the Italian Constitutional Laws.

With specific reference to the privatisation rules, Article 25 of the new decree provides that administrative bodies must sell any interests which, at the date of entry into force of the decree, it owns directly or indirectly in companies that

- Do not provide any of the services listed in Article 4
- Have purposes that are not consistent with Articles 4 and 5
- Have no employees, or have more directors than employees
- Carry out the same, or similar, activities as the ones carried out by other, existing public companies or public entities
- In the three years before the entry into force of the new decree achieved average revenues of less than €1 million
- Have negative financial outcomes in four of the previous five accounting periods (with the exception of companies operating in the public services sector).

> "The decree provides for new privatisation rules that will apply to publicly-owned companies."

MANDATORY SALES AND WINDING UP PROCEDURES

Within six months from the date of entry into force of the new decree, administrative bodies must analyse the companies in which it has interests and identify those that must be sold.

The outcomes of the analyses must be notified to the relevant offices of the Italian Court of Auditors (the Corte dei Conti).

The sales must take place within one year of the conclusion of the analysis (18 months after the entry into force of the new decree). If an administrative body does not carry out its analysis, or the sale does not occur within this period, the administrative body cannot exercise its corporate rights and its interests will be liquidated in accordance with the relevant provisions of the Italian Civil Code.

With specific reference to the sale procedure, the new decree provides that, in relation to

- State-owned interests, the final decision on the sale will be taken by the Italian Government by means of a specific decree of the President of the Italian Government
- Interests owned by a Region, the final decision on the sale will be taken by the Regional Committee (Giunta Regionale) by means of a decree made by the President of the Region
- Interests owned by a Municipality, the decision on the sale will be taken by the City Council (Consiglio Comunale).

In all cases, the procedure for the sale of public interests must ensure sufficient advertising and be compliant with the principles of transparency and non-discrimination. The sale procedure will normally take place through a public tender. In exceptional cases, however, an administrative body may sell its interests through a negotiation procedure with a single private buyer. In these cases, the administrative body must specifically clarify the economic expediency of the sale, with particular reference to the price proposed by the private buyer.

EXCEPTIONS

The privatisation rules of the new decree will not apply to listed public companies (such as Enel S.p.A., Eni S.p.A. and Finmeccanica S.p.A.) and to some specific public companies or groups indicated in Annex A of the new decree: Coni Servizi, EXPO, Arexpo, Invimit, IPZS, Sogin, Anas Group, GSE Group and Eur Group.

The new decree is currently undergoing a final assessment with the purpose of fine tuning of the text. After it receives governmental approval, the final text will be submitted for consultation purposes to the competent Parliament Committee (Commissione Parlamentare) and to the Consiglio di Stato. Once approved by these bodies, the new decree will be signed by the President of the Italian Republic and enter into force.

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EUROPE > ANTITRUST

Recent Antitrust Judgments Illustrate How the European Commission Can Correct Its Errors Post-Annulment

LIONEL LESUR, LOUISE ABERG AND MAFALDA DE OLIVEIRA DIAS

Three recent decisions highlight the European Commission's ability to correct an illegal decision that has been annulled by the GCEU.

In the case of an annulment of a Commission decision, Article 266 of the Treaty on the Functioning of the European Union requires that the Commission "take the necessary measures to comply with the judgment" of the General Court of the European Union (GCEU). Provided that any applicable limitation period has not expired, the Commission may then adopt a new decision, taking care to avoid the illegalities identified by the GCEU in the first decision.

> "A successful GCEU challenge of a Commission decision can be short-lived."

The new decision can be different from the first, as illustrated by the *Mitsubishi* and *Toshiba* judgments of 19 January 2016, but it can also be substantially the same, as illustrated by the *Éditions Odile Jacob* judgment of 28 January 2016.

Mitsubishi and *Toshiba* concerned fines imposed by the Commission on these companies for their participation in a cartel. The GCEU annulled the fines on the ground that the Commission had infringed the principle of equal treatment when calculating them.

Following the annulment, the Commission adopted a new decision, imposing lower individual fines. The GCEU upheld these lower fines upon a second challenge by Mitsubishi and Toshiba.

Éditions Odile Jacob arose out of the Commission's conditional authorisation of a merger. Based on the report prepared by a consultant, the Commission approved a company as a suitable purchaser for the assets. When challenged by Éditions Odile Jacob, the GCEU held that the consultant did not satisfy the conditions of independence required by the Commission's conditional merger authorisation and so annulled the Commission's decision.

As a result, the Commission approved a new consultant and, based on the new report, issued a new decision, which approved the same proposed purchaser. Éditions Odile Jacob's challenge to the Commission's second approval decision was rejected by both the GCEU and, on appeal, by the Court of Justice of the European Union.

Mitsubishi and *Toshiba* show that, where the Commission makes a substantive error, it is obliged to correct that error in any subsequent decision taken to replace the annulled decision. *Éditions Odile Jacob* conversely illustrates how a successful GCEU challenge of a Commission decision can be short-lived if the challenge succeeds on the basis of a defect that the Commission can correct legally the second time around.

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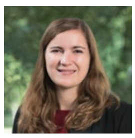

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Germany: The New Hub of Europe's Real Estate Market

JENS ORTMANNS AND KIAN TAUSER

PWC's Emerging Trends in Real Estate Europe 2015 survey places Berlin, Hamburg, Munich and Frankfurt among the top 10 most active real estate markets in Europe. No other county has more than one city listed.

CONTINUED >

Berlin is also ranked as the number one city for real estate investment prospects, with Hamburg at number four and Munich just out of the top 10 at number 11. It is clear that the German real estate market is the most significant in Europe.

Tax-optimised investment and holding structures are available domestically, for example through German asset managing LPs or fully tax transparent investment funds, and for EU and overseas inbound investors, for example through an LP or corporate entity resident in another EU Member State which in turn is debt financed to optimise the local tax obligations and to facilitate subsequent repatriation of money.

> "Germany allows for certain tax-neutral transfers of legal entities within the European Union."

There are a number of investment structures, developments in transfer tax, written form German lease agreements, and sustainability and green building trends in the German property market that make the country's real estate market an extremely attractive target for both domestic and foreign investors.

TYPICAL INVESTMENT STRUCTURES

German law provides for a variety of regulated and unregulated vehicles (such as limited partnerships (LPs), corporations and investment funds) suitable for real estate investments from a corporate governance, financing and capital maintenance perspective. Direct investment through foreign vehicles, for example, *via* Luxembourg or Dutch LPs, corporations or investment funds are also an option. Relevant considerations for determining the most suitable investment structure include real estate transfer trust (RETT) optimisation and income tax optimisation.

Rental income and capital gains from the sale of German real estate by way of an asset deal are subject to German income taxation. For corporate investors, the applicable corporate income tax rate is 15.825 per cent (including the solidarity surcharge).

Acquisition structuring is usually aimed at ensuring that German trade tax, which is between 7 per cent and 18 per cent, depending on the municipality, doesn't also apply. Acquisition structures are generally tailored to ensure that interest on acquisition debt and transaction costs are tax deductible in Germany.

Germany has made progress in recent years in offering flexible regulated entities, such as the fully tax transparent Special Investment LP. The financial supervisory authority, BaFin, is also proactive in facilitating inbound investments by, for example, making rulings which ensure that German supervisory law regimes don't apply to structures such as club deals and joint venture investments.

Joint ventures and club deals usually invest through partnerships. The number of listed real estate companies is not as high in Germany as in many other comparable markets, because real estate investment trusts are only eligible to a very limited extent for certain residential investments.

As regards group reorganisations, it is worth noting that Germany allows for certain tax-neutral transfers of legal entities within the European Union, provided a previously existing German taxation right is not thereby excluded.

Historically, the German real estate market largely consisted of open-ended funds and special funds, *i.e.*, tax transparent vehicles open for retail and professional investors and managed by professional fund managers. Currently, many open-ended funds face severe challenges and the industry is expected to consolidate. At the same time, an increasing amount of investments by foreign investors are being channeled through other European jurisdictions, namely Luxembourg, where offering vehicles are less regulated and more tax efficient.

Luxembourg is about to implement a new investment vehicle, the reserved alternative investment fund (RAIF). The fund itself is exempt from regulation but the fund manager is not. The RAIF, and other flexible investment solutions, make Luxembourg increasingly attractive as an investment platform for investments into the German real estate market.

REAL ESTATE TRANSFER TAX

Since 2006, the transfer tax regime applicable on real estate investments has been ruled by the federal states (Bundesländer). Up until January 2016 the RETT across Germany was 3.5 per cent. Following various increases in numerous federal states, the RETT now ranges from 3.5 per cent to 6.5 per cent, as follows:

3.5% Munich (Bavaria)

4.5% Hamburg

5.0% Stuttgart (Baden-Wurttemberg)

6.0% Berlin

6.0% Frankfurt (Hesse)

6.5% Düsseldorf/Cologne (Northrhine Westfalia)

With respect to asset deals, the RETT rate applies to the purchase price. RETT is also applicable on interest deals involving LPs, share deals with respect to corporations, and fund units with respect to certain investment funds.

There are strategies available to reduce or even exclude the triggering of RETT in transactions. With respect to corporate entities that (in)directly hold German real estate, RETT-blocking structures may be used, provided that an external 5.1 per cent shareholder remains. With respect to LPs, majority stake acquisitions of up to 94.9 per cent interest in the LP are combined with tailored call/put option mechanisms to allow for an acquisition of the remaining 4.9 per cent minority stake after at least five years. With respect to investment funds, real estate may be acquired RETT-free by retaining the same investment company.

> "The German real estate market is the most significant in Europe."

In intra-group reorganisations, there are further options available for RETT optimisation and alleviations, such as intra-group exemptions and individualised structuring of the consideration.

GERMAN LEASES: THE STATUTORY WRITTEN FORM REQUIREMENT

An ongoing issue when acquiring German real estate is the "written form requirement", which is applicable to lease agreements. The German Civil Code stipulates that a fixed term lease that does not comply with the written form requirement can be terminated by each party within the statutory notice period, which is between three and six months. Written form issues therefore form a vital part of due diligence, and leases that do not comply with the written form requirement are considered as not being financially viable.

In practice, the most relevant issues relating to the written form requirement include the designation of the parties, the leased object, the rent and the term of the lease, all of which must be included in the lease documentation consistently, clearly and unambiguously. Other frequent issues are side letters or other (including verbal) agreements outside the lease documentation.

GREEN BUILDINGS

Sustainability is increasingly considered as a key requirement by many institutional investors. Corporate governance, compliance and environmental awareness requirements accordingly affect building projects and contracts, including the terms of commercial lease agreements.

A "green" lease would typically include specific terms in relation to the supply of water, heating and electricity, and building and fit-out materials. Under the Energy Savings Regulation, the landlord also has to provide the tenant with an energy certificate proving the building's energy efficiency. Property owners have recently been authorised under new legislation to charge modernisation costs to tenants, as long as the measures meet certain sustainability criteria.

To enable a building to be considered "green", various certification systems, such as the German Sustainable Building Council, the Building Research Establishment Environmental Assessment Method, and the US Green Building Council's Leadership in Energy and Environmental Design certificate, have emerged. Institutional investors will typically expect new developments to achieve the standards of at least one of these systems, and there is considerable incentive to make sure they do. In some cases, banks offer reduced margins for financing green buildings, and some make green building certification a condition for funding.

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Pitfalls to Avoid When Acquiring French Vineyards

BERTRAND DELAFAYE

Although acquiring a vineyard in the heartland of winemaking country is a dream real estate purchase, potential buyers must be wary of potential pitfalls to avoid a hangover.

In recent years, the number of acquisitions of French vineyards by foreign investors has increased substantially. Acquirers of vineyards are motivated not just by the pleasures of owning land and wine, but also by the profits that may be made by exporting the wine to countries such as China, where the going price for a bottle may be up to ten times that in France. China is the world's fifth largest consumer of wine and the leading importer of Bordeaux. Hundreds of Bordeaux château are in Chinese hands, testifying to the country's seemingly unquenchable thirst for French vineyards.

A brief overview of what's involved in purchasing a vineyard reveals that it is actually a more complex transaction than might be expected. Specific and challenging issues may arise with regard to due diligence, financing and the pre-emptive right of the French Government to purchase any vineyard that comes up for sale.

DUE DILIGENCE

As with all real estate purchases, due diligence is key. Evaluations of vineyards are, however, distinguished by their high level of complexity. Audits will typically require the coordination of multiple experts, including lawyers, accountants, environmental inspectors, architects and one or more wine specialists. In addition to evaluating the quality and marketing of the wine produced, due diligence will include a valuation of the estate, production facilities and wine stock.

The vineyard's compliance with tax, employment and environmental regulations, particularly those related to the treatment of wine effluent, must also be assessed. The auditors must check the use of trade marks and *château* names, and confirm that the plots of land for sale are within the applicable appellation. The identity of the owner and consistency between the notary deeds, land register, real estate register and the *Casier vitricole* must be verified. In addition, a lawyer should ensure that any operating agreements cannot be reclassified as rural leases subject to the French Rural Code.

FINANCING

About 90 per cent of wineries are structured as two companies, one owns the land on which the grapes are grown (the owning company), and the other manages the daily operation of the vineyard and produces and markets the wine (the operating company).

The owning company rents the land to the operating company. Due to the exceptionally high land prices involved, the owning company is often worth much more than the operating company. Because operating companies are generally valued on the basis of a multiple of their profits and rarely own highly valued assets, operating companies are often poorly valued. Their projected business profits, except where boosted by a history of high-priced exports, will generally not be enough to ensure timely and full repayment of the loan with interest, which naturally makes lenders nervous.

> "A liquid asset, blending cultural depth and personal colour."

Because the value of the land far exceeds the potential for profit, French banks consider most vineyard acquisitions to be personal acquisitions for pleasure rather than profit. As such, French banks are typically not satisfied with a real guaranty, *i.e.*, securing the loan with company assets or shares in the owning and operating companies. As a consequence, they generally, additionally, require a personal guaranty, which some investors are reluctant to grant. This may push investors to find financing outside France, or to opt for an equity-based transaction, rather than a debt-leveraged one, possibly to their detriment. A solid business plan that can demonstrate significant cash flow will help secure more favourable financing.

THE FRENCH GOVERNMENT'S PRE-EMPTIVE RIGHT TO BUY

The pre-emptive right to purchase a vineyard is held by the *Société d'aménagement foncier et d'établissement rural* (SAFER), a nonprofit agency under the control of the French state, the purpose of which is to protect the general interest by maintaining agricultural land, protecting the environment and preventing speculative purchases. Two months prior to the expected date of sale, the seller or notary must disclose to SAFER the nature, location and legal description of the property to be sold, as well as the terms of sale and identities of the parties. At this point, SAFER has the right to step in and purchase the vineyard itself.

Until 2014, it was fairly easy to circumvent SAFER's pre-emptive right to buy, since it did not apply to the transfer of company shares. Ownership of a vineyard could be effectively transferred via the sale of shares of both the owning and operating company. Since 2014, however, under Article 29 of the Future of Agriculture, Food and Forestry Act (No. 2014-1170) passed on 13 October 2014 (amending Article L.141-1), SAFER's pre-emptive right now applies to share transfers. SAFER may choose to exercise its right over only part of the purchase, but the seller is not required to part with less than all of the property. This means that if the seller does not want to sell the specific part demanded by SAFER, either SAFER will acquire all the property, or SAFER renounces its preemptive rights and the sale to the purchaser can go ahead.

In the case of a share transfer, the required disclosure to SAFER is broader, and includes the transferring company's by-laws and financial statements for the past three years, any contractual and pre-contractual agreements, any asset and liability guarantees, any obligation having financial implications for the company whose stock is being transferred, and any information related to pending or potential litigation. A request for complementary information will delay the sale until the notary or seller provides the requested information or indicates why it cannot be transmitted. Failure to notify SAFER may result in rescission of the sale, if the property was subject to SAFER's preemptive right or, if not, in a fine of between €1,500 and 2 per cent of the transaction amount.

Although this obligation to provide information may delay an acquisition, the risk that SAFER will exercise its right of pre-emption is actually quite low, especially with respect to highly valued properties like vineyards. In fact, in 2014, the total value of purchases made by SAFER through its preemptive right was only €52 million, although this figure does not reveal the number of potential purchases derailed by SAFER exercising its right to buy a part of the plot.

Despite these obstacles, the acquisition of a vineyard, a liquid asset, blending cultural depth and personal colour, remains an attractive option for investors, particularly given the rise of export prices driven by the growing market in Asia.

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> "French banks consider vineyard acquisitions to be personal acquisitions for pleasure rather than profit."

Shifting Business Interruption Risk Allocation in a Post-Sandy World

WILLIAM STEMPEL

Landlords hit by insurance exclusions in the aftermath of Hurricane Sandy are hitting back by requiring tenants to use the proceeds of business interruption insurance to pay rent.

Before Hurricane Sandy hit the United States in October 2012, in the event of a casualty adversely affecting a tenant's ability to operate its business or access its premises, casualty provisions in commercial leases in New York City typically provided for an abatement of rent in proportion to the affected area of the premises. As a separate stand-alone covenant, tenants were often required to maintain business interruption insurance, which was usually equal to a fixed dollar amount or the sum of a predetermined number of monthly rent payments.

Notwithstanding the obligation for tenants to maintain business interruption insurance, there was no corresponding lease obligation requiring tenants to use business interruption insurance proceeds to pay rent to their landlord in the event of a casualty. In addition, landlords did not negotiate the specific terms of such policies. This meant they had no control over whether or not the business interruption insurance was paid to them and were unable to limit or restrict exclusions from coverage limiting a tenant's ability to collect on a claim. Instead, landlords maintained rent-loss coverage to protect against loss of income.

THE AFTERMATH OF THE STORM

Hurricane Sandy caused landlords and tenants to reassess the application of business interruption policies in commercial leases. As a result of catastrophic flooding and the cessation of public utilities, in many parts of Manhattan, particularly lower Manhattan and the Financial District, hundreds of buildings and dozens of streets were closed.

Landlords and tenants expected that they would be made whole by business interruption insurance policies (for tenants) and rent loss insurance policies (for landlords). Unbeknownst to both parties, however, many business interruption and rent loss insurance policies included numerous and broad exclusions limiting recovery for certain events including, without limitation, damages resulting from flooding, acts of God, natural disasters, unavailability of public utilities, the closure of an entire building, and the closure of the premises or building by governmental authorities.

Facing US$ billions in insurance claims, insurers exploited these exclusions and denied claims. For example, if a policy contained an exclusion for flood damage, the damage and loss was classified as being caused by a flood; if a policy contained an exclusion for natural disasters, the damage and loss was classified as being caused by a natural disaster. These exclusions enabled insurers to reject or limit otherwise legitimate claims.

> "Facing US$ billions in insurance claims, insurers exploited these exclusions."

Most landlords were unaware that their leases permitted, or did not expressly prohibit, exclusions from coverage, as certificates of insurance only provide broad overviews of the type and amount of coverage. They do not specify exclusions or limitations that would impact an insured's ability to collect following a casualty event. Even if a lease required that a tenant pay business interruption insurance proceeds to a landlord, which before Sandy was atypical, a landlord would remain exposed unless the casualty abatement was specifically conditioned upon a tenant collecting on business interruption insurance proceeds and paying them to the landlord. Effectively, in these circumstances, landlords would unintentionally secondarily insure tenants' business interruption policies and backstop tenants' loss of income as a result of a claim being rejected owing to specific exclusions from coverage. In these instances, tenants would receive an abatement of rent regardless of whether or not their landlord received the benefit of rent-loss or business interruption coverage.

To the extent that tenants were not required to pay their landlord their business interruption insurance proceeds as rent, landlords were forced to make a claim on their own rent loss policies, many of which were insured on a portfolio-wide basis with insurance limits equal to a fraction of the exposure caused by a building-wide catastrophe. Many landlords did not anticipate, or did not want to pay the premium to cover, the interruption of rental income for an entire building, and were thus under-insured and suffered significant losses.

MOVING ON

In the aftermath of Hurricane Sandy, some landlords have sought to mitigate their casualty exposure and "move the market" by shifting the allocation of risk for tenant business interruption insurance policies actually paying out in the event of a casualty. New York landlords still require tenants to maintain business interruption coverage, but in some leases landlords condition casualty rent abatements upon the viability of a tenant's business interruption insurance policy. For example, if a business interruption insurance policy does not pay out because of an insurer enforcing an exclusion from coverage, there will be no abatement of rent.

Post-Hurricane Sandy, one prominent New York landlord now requires new tenants to assign proceeds of business interruption insurance to the benefit of the landlord under the following provision:

> *Notwithstanding anything to the contrary contained in this Article xx, (x) if Landlord or any mortgagee of the Building shall be unable to collect insurance proceeds (including rent insurance proceeds) for any reason other than a negligent act of Landlord, its employees, contractors or agents, there shall be no abatement of Fixed Rent or Additional Charges, and (y) Tenant's right to an abatement of Fixed Rent and/or Additional Charges shall only be enforceable if (i) such casualty renders the Premises partially or wholly unusable for a period in excess of twelve (12) months and (ii) Tenant has collected on (and paid to Landlord) Business Interruption Insurance proceeds for the twelve (12) months subsequent to the date of such casualty. For the avoidance of doubt, it is the intent of the parties that any proceeds available under Business Interruption Insurance must be exhausted prior to Tenant receiving any abatement for damage or other casualty to the Premises under this Lease.*

This shift in allocation of risk means that a tenant may now be responsible for any gaps in coverage to the extent that an insurer refuses to honour a business interruption policy, on the basis that a tenant is in the best position to negotiate and understand specific exclusions to their coverage. As a result, in these instances exclusions will now be the responsibility of a tenant rather than the landlord, and if a policy does not provide sufficient coverage, or contains too many exclusions, a tenant can elect to pay an additional premium to eliminate those exclusions.

As most tenants are not in the insurance business, and most tenant's lawyers are averse to changes in what is considered "market", this paradigm shift in risk allocation has faced vociferous opposition from tenants and their counsel. Some landlords are, however, aggressively seeking to frame the risk allocation issue in terms of which party is better suited to backstop a rejected claim and act as the secondary insurer of a business interruption policy. Landlords that are successful in this pursuit will be in a much stronger position to weather the storm and protect vital streams of rental income following a major casualty event.

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FinCen Takes Aim at Real Estate Secrecy in Manhattan and Miami

KEITH PATTIZ AND GREGG FIERMAN

A trial programme launched by the US Department of the Treasury will affect "all-cash" purchasers of US$million residential real estate in Manhattan and Miami-Dade County.

On 13 January 2016, the United States Department of the Treasury issued Geographic Targeting Orders (GTOs) that will temporarily require US title insurance companies to identify the natural persons behind companies used to pay "all-cash" (no financing) for high-end residential real estate in Manhattan, New York and Miami-Dade County, Florida.

RATIONALE FOR THE GTOS

The US Government is concerned that these all-cash, high-end residential purchases may be conducted by individuals attempting to hide assets as part of money laundering or other fraudulent schemes. The expectation is that this disclosure requirement will assist law enforcement with combating money laundering in the real estate sector. By establishing the natural persons involved in these targeted transactions, the Treasury is hoping to identify individuals engaged in illicit activities who would otherwise be hidden behind the entities utilised for these acquisitions.

NARROW FOCUS

There has been a large volume of high-end condominium purchases by foreign buyers using a limited liability company, limited partnership, S corporation or other single purpose entity that enables the actual ownership to remain undisclosed. While most of these transactions involve purchasers who simply like the stability of US real estate and are not involved in fraud or money laundering, there has been significant media focus on flight capital where the investments are from questionable sources.

The GTOs form a 180 day pilot programme that launched on 1 March and is initially confined to Manhattan and Miami-Dade County as these are two major markets for high-end residential properties. Depending on the results of this initial programme, the duration, geographic scope and class of real estate covered by the GTOs could all be expanded in the future.

"The reporting is currently confined to all-cash transactions."

RATIONALE FOR CARVE OUTS FROM REPORTING

The reporting is to be done initially by title companies. Since all-cash transactions do not require the purchase of title insurance, it is conceivable that many transactions, previously undertaken with title insurance, will be completed without title insurance. While this is not something that we would recommend, it is an option for purchasers who do not want their transactions reported.

> "The reporting is to be done initially by title companies."

The reporting is currently confined to all-cash transactions, which are defined in the GTOs as a transaction without a bank loan or other third party financing, when payment of any portion of the purchase is made by cash, cashier's cheque, certified cheque, traveler's cheque or money order. Wire transfers are not considered as all-cash for the purposes of the GTOs. The thinking, as articulated by the Treasury, is that banks are already able to monitor wire transfers and lending transactions through existing reporting requirements.

The covered class of assets is residential real estate costing US$3 million and over if located in Manhattan, and US$1 million and over if located in Miami-Dade County, as this asset class has received the most attention as a conduit for illicit investment. This means lower cost residential and commercial transactions are not currently subject to the new reporting requirements. As this is a trial programme, however, conceivably the scope may change after the 180 day trial period.

INFORMATION TO BE DISCLOSED

For those transactions that are subject to the reporting requirements under the GTOs, the title companies will be required to obtain and record certain information about the representatives and/or owners of the purchaser. For the individual primarily responsible for representing the purchaser, and each beneficial owner of the purchaser, this information includes a copy of their driver's license, passport or other official identifying documentation.

A beneficial owner is defined under the GTOs as each individual who, directly or indirectly, owns 25 per cent or more of the equity interests of the purchaser. Additionally, if the purchaser is a limited liability company, the name, address and taxpayer identification number of all its members must be disclosed by the title companies on the forms filed with the US Government under the GTOs.

IMPACT

Most transactions of this nature are undertaken with these opaque, single purpose entities to provide privacy and confidentiality for perfectly legitimate reasons. The purchaser of a high priced residence may have valid reasons for keeping that acquisition private and free from disclosure to the general public. For these law-abiding real estate purchasers, there should not be cause for concern regarding the new reporting requirement under these GTOs.

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