START-UP / VENTURE CAPITAL

Dear Reader,

It's half-time for 2019 – we want to use the opportunity to take a deep breath and take stock. Germany is quickly becoming a start-up country and, apart from residual issues, such as the fact that financing rounds are too small by international standards, our Start-up/Venture Capital Team has had much to do in the first half of 2019. We are very pleased with the strong growth in our sector and the great response we have received for our work. We would like to thank all of our clients, both old and new, for their trust in us. We enjoy working with you and are looking forward to helping you to make our business location more sustainable. Keep on pushing!

Unfortunately, we must admit that our newsletter has suffered somewhat as a result of our workload – that's why we have a mid-year edition of our newsletter.

You can find the following articles in this issue of our newsletter:

- **Tassilo Klesen**, one of our colleagues from our Berlin office, looks at the buzzword "*purpose*" and how it can be legally secured.
- Next is an article by our colleague **Dr Christian Gloger**, who is a partner in the New York law firm of Kleinberg, Kaplan Wolff & Cohen. We asked him to tell us how and where to best raise capital in the US at the moment.
- The article by **Laureen Lee** keeps our sights on the other side of the Atlantic. She looks at the ECJ judgment in *Maximilian Schrems v Facebook Ireland Limited* and the answer to the question of when personal data may be transferred to the USA.
- **Christian Hess**, one of our IP lawyers based in Munich, provides an overview of the new Trade Secrets Act.
- Our labour law duo, **Dr Erik Schmid** and **Dr Michaela Felisiak** have provided us with two articles for this issue. One looks at the important judgment of the ECJ of 14 May 2019 on monitoring working time. The second examines the practical question of whether it is sufficient for employees to send their employers a WhatsApp message to let them know that they are ill.
- We finish with an article by **Christian Kalusa** entitled "*A short word about Vesting*". Too often over the last few months, we have been presented with clauses that initially have little to do with vesting. Christian clarifies several aspects.

Happy reading and thanks for sticking with us!

Best regards,
The BEITEN BURKHARDT Start-up/Venture Capital Team

UPCOMING EVENTS

4th Start-up Night 2019

The fourth VIR and TIC Travel Start-up Night 2019 will be held in the Frankfurt offices of BEITEN BURKHARDT. The event is free for start-ups that were established fewer than three years ago.

The Travel Start-up Nights are a joint initiative of the Travel Industry Club and the VIR. These events bring together established players and young founders in the tourism sector to further encourage and strengthen innovation in the sector in Germany. The

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relaxed atmosphere of the events invites easy networking. If you are an established tourism company, come and be inspired by the founders' spirit! Attendance is free for VIR members.

You can find more information under the following calendar entry.

4th Start-up Night: Frankfurt am Main, 28 August 2019

Corporate Venturing – strategically invest in start-ups

The Corporate Venturing Workshop will look at the most important legal and commercial issues related to the implementation of a corporate venturing strategy:

- Key aspects of direct investments in start-ups from the point of view of a corporation,
- Establishing accelerator and incubator programmes,
- The organisational measures at corporate level necessary if strategic added value is to be obtained through direct investments,
- Window on technology through investments in VC fund structures,
- The difference between direct investments and investments in VC fund structures when selecting the right corporate venturing strategy,
- A comparison of existing corporate venturing structures with new approaches.

You can find more information under the following calendar entry.

Corporate Venturing Workshop: Frankfurt am Main, 29 August 2019

Steward-Ownership for Start-ups

While some DAX corporations are still busy, trying to find a clear purpose (*Handelsblatt* dated 18 April 2019 – "The question of why: what gives our work meaning" ("*Die Frage nach dem Warum: Was unserer Arbeit Bedeutung verleiht*")), and the management orientation towards common good known under the term "purpose" is back in fashion (FAZ dated 11 February 2019 – Timo Meynhardt, "Purpose – more than a manager style?" ("*Purpose – mehr als eine Managermode?*")), many start-ups are establishing and legally securing their so-called steward-ownership when founding their company or during the early stages.

BACKGROUND

What does steward-ownership mean?

In short, companies will own themselves or have steward-ownership structures if they have ensured, in a legally binding way, that (1) independent steward-owners carry full responsibility for the company, and (2) only those persons, who identify with the purposes of the company and are not merely motivated by monetary incentives, may be owners.

Two principles underpin steward-ownership:

THE SELF-DETERMINATION PRINCIPLE

Decisions are taken and implemented within the company by people who are active in the company, rather than by distant investors or shareholders. The majority of the voting rights – thus control of the fulfilment of the company's purpose – are in the hands of management; the company is therefore self-determining. The steward-owners have taken over the responsibility for the actions, values and legacy of the company. The ownership of the voting rights cannot be inherited or sold freely, but can only be transferred to persons who are directly associated with the purpose of the company. Companies therefore cannot be traded as an object of speculation and sold to the highest bidder. Importantly, voting rights and rights to profits are, in principle, separated, in order to ensure that economic interests do not dominate the decision making process.

THE PURPOSE PRINCIPLE

In addition, steward-ownership makes it possible for everyone within the company to view profits as a means to an ends, and not as an end in itself. Profits are primarily reinvested, used to repay investors or to pay salaries, or they are donated.

MOTIVATION

What motivates founders to decide in favour of steward-ownership?

Numerous motivating factors have emerged:

- Allegiance to a purpose and values;
- Long-term orientation;

- Productivity, motivation and retention for talented staff;
- Retention of customers;
- Independence and sustainability.

The aim of establishing a steward-ownership structure is to anchor the purpose and values in the structure of the company. Purpose ownership facilitates generations of ownership in trust, making it possible to realise a business idea while remaining loyal to and continuing to develop the values of the company. The real hope is that a company in steward-ownership will be economically more successful in the long run.

LEGAL IMPLEMENTATION – VETO-SHARES MODEL

There are various models, but three are more prevalent in the German-speaking countries: (i) the veto share model, (ii) the single foundation model, and (iii) the double foundation model.

For start-ups, establishing a foundation is normally out of the question, so that the veto-share model is preferred:

A feature of the veto-share model is a relatively lean corporate structure. Steward-ownership is secured by a "golden share".

Companies applying the veto-share model will have three classes of Shares:

A SHARES ("TRUSTEE SHARES")

These shares are held by those who work for the company and are endowed with voting rights.

The shares cannot be sold, nor can they be inherited. The articles of incorporation of the company will specify how these shares can be passed to another party. For example, a successor of a trustee, who leaves the company, may make a proposal for the shares to be passed to a successor body, or the decision could be left to the employees.

B SHARES

These shares may be held by investors, non-profit organisations, employees or founders and have profit sharing rights, but no voting rights. The profit sharing rights are capped when the shares are held by persons who work for the company, in order to avoid conflicts of interest. In any case, it is advisable to subject these shares to a buy-back right that applies in the case that the liquidity situation of the company improves.

VETO SHARES ("GOLDEN SHARES")

Holders of these shares are entitled to veto any decision that goes against the steward-ownership principles, to which the company has already pledged itself. The drafts of the articles of incorporation and shareholders agreement must be carefully assessed, in order to ensure that the foreseen corset will not prove to be too cumbersome once it is imposed.

Shares are held by a "veto service" foundation. The foundation must fulfil certain requirements in order to be considered for this role.

SUMMARY AND OUTLOOK

It is becoming increasingly attractive to anchor the steward-ownership in the legal structure of a start-up, so much so that it is now in demand. Indeed, the veto-share model developed into a relatively easy structure to be implemented easily.

However, many European countries have already developed their own legal regimes, which fulfil the spirit and purpose of steward-ownership in a better way. "Purpose-Stiftung" has already made a specific proposal for Germany. A move by German legislators to focus on this issue in the near future would be great to avoid any competitive disadvantage.

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What Non-U.S. Venture Capital Fund Managers Need To Know Before Pursuing U.S. Investors

As the European venture capital fund industry continues to grow, many German and other European-based venture capital fund managers seeking to raise capital from U.S. investors are realizing that the United States regulatory landscape for private investment funds presents several challenges. While U.S. investors generally have an appetite for investing in early-stage or later-stage ventures around the globe, there are a number of business, legal, regulatory and tax hurdles to jump through for everybody who aims to tap into the U.S. market. This article summarizes key legal and U.S. regulatory considerations under the U.S. Securities Act of 1933, as amended (the "**SECURITIES ACT**"), as well as a particular exemption for venture capital fund managers from registration as an investment adviser under the U.S. Investment Advisers Act of 1940, as amended (the "**ADVISERS ACT**"). We will address in separate articles considerations under other relevant U.S. laws governing the private investment funds industry, including important restrictions for U.S. capital raising pursuant to the U.S. Investment Company Act of 1940, as amended (the "**INVESTMENT COMPANY ACT**"). We will also separately address the adequate U.S. tax structure for a successful fund raising in the United States. Interested venture capital fund managers should also become familiar with effective marketing strategies, which include capital introduction meetings, road shows, the appropriate presentation of the manager's track record and the engagement of the "right"

service providers (placement agents, legal counsel, fund administrators and auditors) that can be determinative for the success of any U.S. fund raising.

PART 1 – THE RULES AND REGULATIONS GOVERNING PRIVATE FUND OFFERINGS IN THE U.S.

In an effort to protect U.S. investors and the integrity of the securities industry, several rules and regulations have been developed over the years that impose certain restrictions on soliciting and accepting investments from U.S. Investors. Moreover, in the wake of several large scale frauds, like Ponzi schemes, the industry has evolved to become more conscious and vigilant about protecting Investors.

Any offering of "securities" in the U.S. must be conducted in compliance with applicable U.S. security laws, including the U.S. Securities Act of 1933, as amended (the "**SECURITIES ACT**"). The term "securities" generally covers the offering of "shares", "units" or "interests" in private equity funds, venture capital funds, real estate funds or hedge funds, whether structured as limited partnerships or any other kind of company. Therefore, it is important for private fund managers, including venture capital funds, to be familiar with the various rules and regulations before beginning activities that target U.S. investors. Importantly, the sale of an interest in an investment fund that violates the Securities Act is arguably void, and investors may claim under U.S. federal or state laws to get all of their invested capital back which they may do if that fund is facing significant losses.

WHY CARE ABOUT ACCREDITED INVESTORS?

Under the Securities Act, an issuer that offers or sells its securities in the United States must register the offering of those securities under Section 5 of the Securities Act or must qualify for an exemption from such requirement. Such an exemption is available for any offering of securities which does not involve a "public offering".

Because there could be different views on what exactly constitutes a "public offering", Rule 506 of Regulation D promulgated by the U.S. Securities and Exchange Commission ("**SEC**") provides for a "safe harbor" under Section 4(a)(2) of the Securities Act. If an issuer of securities (including a venture capital fund) satisfies the conditions of the Rule 506 safe harbor, its offering will be deemed non-public and exempt from the Securities Act's registration requirements. The overwhelming majority of venture capital and other private investment fund managers choose to satisfy the conditions under subsection (b) of Rule 506 to utilize this safe harbor.

Generally, the Ruke 506(b) safe harbor permits an issuer to sell its securities only to persons who are "accredited investors".[1] "Accredited investors" are defined in Rule 501(a) of Regulation D, and include, among others:

- Natural persons who, either individually or jointly with their spouse, have a net worth, exclusive of their primary residence, in excess of U.S.$1 million, or who have had an annual income in excess of U.S.$200,000 (or U.S.$300,000 when combined with their spouse's income) in each of the last two years and have a reasonable expectation of reaching the same income level in the current year; and

- Entities that have total assets in excess of $5 Million.

NO GENERAL SOLICITATION

Rule 506(b) under Regulation D limits the manner in which an issuer can offer its securities to potential investors. Any form of "general solicitation or general advertising" will disqualify an offering from the Rule 506(b) safe harbor. In practical terms, fund managers who wish to rely on this safe harbor need to send materials to prospective investors in a targeted manner only (and not, for example, post such materials on a website that is accessible to the public in general).

Whether an act constitutes a "general solicitation or general advertising" can be a complex question, and U.S. legal counsel should be consulted prior to engaging in public discussions or presentations of the fund or the Manager.

IS GENERAL SOLICITATION ALLOWED UNDER RECENT RULE 506(C)?

Pursuant to the Jumpstart Our Business Startups Act of 2012 (the "**JOBS ACT**"), the SEC also promulgated Rule 506(c) under Regulation D, which permits an offering to be deemed a "non-public offering" even if it involves general solicitation (i.e., advertising), given certain conditions. While this relatively recent rule created a lot of initial buzz, the private investment fund industry generally favors Rule 506(b), which does not permit general solicitations.[2]

OTHER REGULATION D REQUIREMENTS; STATES' "BLUE SKY" FILINGS

An issuer relying on Regulation D is also required to file with the SEC an online, publicly available, notice on "Form D" within 15 days following the date of the first sale of securities in the applicable offering.

The U.S. state in which a U.S. investor resides may have securities laws of its own (often referred to as "blue sky" laws) which are typically nearly identical in substance to the Securities Act. Most states will permit an offering that qualified for the Regulation D safe harbor to be exempt from state registration. However, states often require that a copy of the Form D filed with the SEC be filed with the state for a fee.

[1] The offer may in theory also include up to 35 non-accredited investors. However, if a fund does accept non-accredited investors, it is obligated to satisfy several other conditions which render accepting the non-accredited investors impractical in many cases. In addition, given the relatively low threshold that an investor needs to meet to qualify as an "accredited investor", it is industry practice to accept only accredited Investors.

[2] In order to qualify for Rule 506(c): (i) there cannot be any unaccredited investors (while under Rule 506(b), however, an offering can remain within the safe harbor if it ends up having up to 35 unaccredited, but sophisticated investors); (ii) the fund must take "reasonable steps" to verify the accredited investor status of each investor and it is possible that these steps will include a review of the investors' tax returns or other similar documents that few investors are willing to provide (while under Rule 506(b), however, the fund can have investors self-verify their accredited investor status without providing any back-up documentation); and (iii) the fund must have elected the Rule 506(c) safe harbor for the offering and can no longer rely on Rule 506(b) (for instance, if the fund discovers that one of the persons who purchased securities in the Rule 506(c) offering is not accredited, the fund cannot amend its election to Rule 506(b)).

ANY BAD ACTORS?

An offering is disqualified from relying on the Rule 506(b) safe harbor if the issuer or certain other persons (including, for example, an investor beneficially owning 20% or more of the issuer's voting power) is a "bad actor", which means having a relevant criminal conviction, regulatory or court order or other disqualifying event occurring on or after September 23, 2013. The issuer can continue relying on the Rule 506(b) safe harbor if, having used reasonable care, it did not identify any covered person as being a "bad actor". Because of this, U.S. legal counsel typically works with fund managers to produce questionnaires that will permit the fund to claim it used reasonable care to identify bad actors.

OTHER CONSIDERATIONS RELATING TO PRIVATE FUND OFFERINGS

European venture capital fund managers should also be familiar with the following regimes, which go beyond the scope of this article:

Under anti-fraud provisions of various U.S. laws governing transactions in securities, an offer of securities needs to be made on the basis of adequate disclosure. Investment fund managers need to provide U.S. investors with all the "material" information that a reasonable investor would want to have before making an investment decision. The question of what information is material should take into account industry practice, laws and regulations applicable to registered offerings that reasonable investors typically expect. As a practical matter, fund managers work closely with U.S. legal counsel to prepare offering memoranda that contain accurate and complete information about the fund and the material risks the investment presents.[3]

PART 2 – IS THE INVESTMENT MANAGER EXEMPT FROM SEC REGISTRATION?

In connection with any U.S. fund raising efforts, the investment manager of venture capital or other private investment funds must also analyze whether the management of assets attributable to U.S. investors, or the management of an investment fund organized under any U.S. law, may require the registration of the investment manager as an "investment adviser" with the SEC pursuant to the Advisers Act. The investment adviser registration, and potential exemption thereof, is an important U.S. regulatory threshold question that is completely separate from compliance with the requirements of a private placement of fund interests in the United States. Investment Adviser regulation under U.S. law is complex, and this article can only provide a brief overview.[4]

As a general matter, a German or other European-based investment manager that has no place of business in the United States[5] does not have to register as an investment adviser with the SEC if it can rely one of the following exemptions:

It will either rely on Section 7(d) of the Advisers Act, provided that (i) the manager has no place of business in the United States, (ii) has no "U.S. clients"[6], and (iii) does not manage any non-U.S. fund that has any "U.S. investor"; or

It will claim the so called "foreign private adviser" exemption under Section 203(b)(3) of the Advisers Act, provided that (i) the manager has no place of business in the United States, (ii) all of the manager's clients are "private funds"[7], (iii) the manager has, in total, less than 15 U.S. clients and U.S. investors, and (iv) the manager manages less than $25 million in aggregate assets across all of its clients attributable to U.S. clients and U.S. investors.

VENTURE CAPITAL FUND MANAGER EXEMPTION?

The two exemptions from investment adviser regulations discussed above will very often not be available for a German or other European-based investment manager because U.S. investors will typically prefer to invest through an investment fund organized under U.S. law for tax reasons and other considerations.[8] Such a U.S. fund is a "U.S. client" of the investment manager, and U.S. persons investing in the fund are "U.S. investors", for purposes of the Advisers Act. Therefore, the two exemptions discussed above would not be available as soon as the investment manager manages an aggregate of $25 million or more in assets attributable to U.S. clients and U.S. investors across all of the investment manager's clients.

However, there are other exemptions that are potentially available. In particular, Section 203(l) of the Advisers Act provides an exemption from registration as an investment adviser for any person whose only advisory clients are solely "venture capital funds". Such venture capital advisers can claim the status of an "exempt-reporting adviser", i.e., they are subject to a less stringent form of SEC registration that requires the investment manager to file a simplified Form ADV and comply with only a limited universe of Advisers Act rules.

Pursuant to the applicable Advisers Act rule, a venture capital fund is a private fund that:

- holds, immediately after the acquisition of an asset, at least 80 percent of its capital commitments in "qualifying investments" (determined excluding short-term holdings) which generally

[3] Note that other rules and regulations restrict the kind of information that can be provided. For instance, there is guidance as to the provision of investment track records, selective disclosure of past investments, etc.

[4] See the following general overview on investment adviser regulation with the SEC: https://www.sec.gov/divisions/investment/iaregulation/memoia.htm. See also "Regulation of Investment Advisers by the U.S. Securities and Exchange Commission", March 2013, at: https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

[5] Rule 203(m)-1 under the Advisers Act defines a "**PLACE OF BUSINESS**" by reference to Rule 222-1(a) under the Advisers Act as any office where the adviser "regularly provides advisory services, solicits, meets with, or otherwise communicates with clients," and "any other location that is held out to the general public as a location at which the investment adviser provides investment advisory services, solicits, meets with, or otherwise communicates with clients."

[6] As an important distinction under the U.S. investment adviser regulation, the "**CLIENT**" of an investment manager is the investment fund or (in case of a separately managed account) the individual or other legal entity whose assets are being managed on a discretionary or non-discretionary basis. Importantly, the "**INVESTORS**" in an investment fund managed by the investment manager are not "clients". Generally speaking (and with few exceptions), a client is a "U.S. client", and an investor is a 'U.S. investor", if that client or investor is a "**U.S. PERSON**" as defined under Rule 902(k) of Regulation S promulgated under the Securities Act.

[7] Being a "**PRIVATE FUND**" has to do with the investment fund's status under the Investment Company Act. Simply speaking, to rely on the foreign private adviser exemption, all clients of the manager must be (i) investment funds (i.e., they cannot be managed account clients) and (ii) exempt from registration with the SEC as an "investment company" either in reliance of Section 3(c)(1) of the Investment Company Act (which limits the number of investors to 100) or (ii) Section 3(c)(7) of the Investment Company Act (which limits the investors to "qualified investors" as defined under the Investment Company Act). Details around these important exemptions under the Investment Company Act are complex and will be covered in a separate article.

[8] In many cases, funds for U.S. investors are organized as Delaware limited partnerships.

consist of equity securities of "qualifying portfolio companies" that are directly acquired by the fund (see further described below);

- does not borrow or otherwise incur leverage, other than limited short-term borrowing (excluding certain guarantees of qualifying portfolio company obligations by the fund)[9];
- represents itself as pursuing a venture capital strategy to its investors and prospective investors[10]; and
- is not registered under the Investment Company Act and has not elected to be treated as a business development Company.

"**QUALIFYING INVESTMENTS**" are generally "equity securities"[11] that were acquired by the fund in one of three ways that each suggest that the fund's capital is being used to finance the operations of businesses, rather than for trading in secondary markets:

- any equity security issued by a qualifying portfolio company that is *directly* acquired by the private fund from the company ("**DIRECTLY ACQUIRED EQUITY**");
- any equity security issued by a qualifying portfolio company in exchange for *directly* acquired equity issued by the same qualifying portfolio company (this exception permits the fund to participate in the reorganization of the capital structure of a portfolio company); and
- any equity security issued by a company of which a qualifying portfolio company is a majority-owned subsidiary, or a predecessor, and that is acquired by the fund in exchange for *directly* acquired equity (this exception enables the fund to acquire securities in connection with the acquisition (or merger) of a qualifying portfolio Company.

A "**QUALIFYING PORTFOLIO COMPANY**" is defined as any company that:

- at the time of investment, is not a publicly traded company in the U.S.;[12]
- does not incur leverage in connection with the investment by the *private* fund and distribute the proceeds of any such borrowing to the private fund in exchange for the private fund investment; and
- is not *itself* a fund (i.e., the company must be an operating company).

Thus, to meet the definition, at least 80 percent of a fund's investment in each portfolio company must be acquired directly from the company, in effect limiting a venture capital fund's ability to acquire secondary market shares to 20 percent of the fund's investment in each company.

The SEC argued as follows:

"*We believe that the limit on secondary purchases remains an important element for distinguishing advisers to venture capital funds from advisers to the types of private equity funds for which Congress did not provide an exemption. However, as discussed above, a venture capital fund may purchase shares in secondary markets to the extent it has room for such securities in its non-qualifying basket.*"[13]

The SEC Staff issued in December 2013 additional guidance regarding the venture capital exemption.[14] To summarize, it permits:

- investments *through* wholly-owned holding companies (without violating the requirement to make "direct" investments);
- acceptance of non-U.S. or U.S. tax-exempt investors through a feeder fund;
- investments in "warehoused" investments (i.e., investments that were initially acquired, on a temporary basis, by the manager and then transferred to the fund); and
- transfer of investments to "side funds" so that each funds holds its pro rata share of each Investment.

SHOULD WE DO IT?

Navigating the regulatory landscape in the United States can seem perplexing and overwhelming. However, the U.S. regulatory regime applicable to soliciting and accepting investments in venture capital funds is fairly comprehensive and has proven manageable for quite some time. With the appropriate legal and compliance advice and processes, accessing the U.S. market is often a very viable option.

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[9] Borrowing cannot exceed 15 percent of the fund's capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days.

[10] Meeting this requirement depends on facts and circumstances as to how the fund describes its strategy to investors, but does not require the use of "venture capital" in the fund's Name.

[11] This includes common stock as well as preferred stock, warrants and other securities convertible into common stock in addition to limited partnership interests.

[12] The Rules provides that the company is not "a reporting or foreign traded company" and does not have a control relationship with a reporting or foreign traded company. Note that the investment is permitted if the portfolio company becomes a reporting company after the Investment.

[13] See SEC Release No. IA-3222; File No. S7-37-10, page 25, at: https://www.sec.gov/rules/final/2011/ia-3222.pdf.

[14] See https://www.sec.gov/divisions/investment/guidance/im-guidance-2013-13.pdf. The SEC further recently amended the venture capital exemption to clarify that "small business investment companies" are "venture capital funds": https://www.sec.gov/investment/secg-rules-203-l-1-and-203-m-1-ia40.

Schrems vs. Facebook: Much ado about nothing? How organisations can transfer personal data to the USA?

The judgment of the European Court of Justice ("**ECJ**") of 6 October 2015 (Case No. C-362/14) invited more media attention than one might expect from such a ruling. Maximilian Schrems, an Austrian lawyer and data protection activist, had brought this case on the allegedly unlawful transfer of his personal data by Facebook Ireland to Facebook USA. In the ruling, the ECJ sided with him and held that the Safe Harbor program was insufficient to create an adequate level of data protection in the USA. To put it differently, this judgment pulled the rug out from under the Safe Harbor program, as a consequence of which EU organizations have to implement other adequacy mechanisms for transfers of personal data to the USA.

CONSEQUENCES FOR INTERNATIONAL DATA TRANSFERS

While the Safe Harbor judgment is most commonly mentioned in the context of social networks, the ruling has important consequences for the international transfer of personal data in general that can easily be underestimated. It applies to the support that many EU organizations receive from service providers located in the USA, for instance when it comes to IT tools for HR and customer management, hosting or cloud applications. The judgement applies as well to the transfer of personal data within groups of companies, such as the transfer of employee data from EU organizations to the parent company or to other entities of the group located in the USA (e.g. in the context of transfers within matrix structures).

Organizations should take action, because data protection authorities not only expect them to ensure that procedures for data transfers to the USA are in line with the General Data Protection Regulation ("GDPR"), but also to provide information on the safeguards that have been put into place. Many data protection authorities emphasise that companies will be fined if they continue to rely on the Safe Harbor program instead of implementing any of the alternatives that are in compliance with the GDPR.

ALTERNATIVES TO THE SAFE HARBOR PROGRAM

Three possible alternatives to the Safe Harbor program will be discussed here: consent of the data subject, the EU-US Privacy Shield and the EU Standard Contractual Clauses. (Because binding corporate rules are commonly used for intra group data transfers only, this alternative is not explored.)

CONSENT

This discussion of the consent alternative uses the transfer of employee data as its example. Consent could be gathered from all data subjects, in this case from every employee; this would allow a company to transfer the personal data of its employees for certain purposes to a recipient in a third country that does not have adequate levels of data protection. However, this alternative was already criticized before the Safe Harbor judgment, considering that an employee's consent can arguably not be given voluntarily in the context of the hierarchical relationship between employer and employee. Practical complications are likely to arise, too. Employees could refuse to give their consent or revoke it, so that their personal data may not be transferred to the USA and perhaps even needs to be deleted. It is therefore advisable to only base the transfer of employee data to the USA on consent in exceptional cases, e.g. when it is clearly in the employee's advantage, for instance in the case of bonus programs.

EU-US PRIVACY SHIELD – SAFE HARBOR 2.0?

After the ECJ declared the Safe Harbor program to be invalid, the EU and the US agreed upon a new program: the EU-US Privacy Shield. The European Commission declared it admissible in July 2016. Like its predecessor, the EU-US Privacy Shield allows US organizations to commit themselves to complying with the data protection principles of the Privacy Shield through a process of self-certification. Increasingly, academics, lawyers and politicians criticize this approach, because problems that have arisen in the context of the Safe Harbor program appear to apply to its successor as well. Notably, the European Parliament and the predecessor to the European Data Protection Board have expressed their concerns about the self-certification process, which range from practical problems in the implementation process to adequate enforcement. Moreover, the EU-US Privacy Shield does not prevent US intelligence agencies from collecting personal data in the name of national security. These issues notwithstanding, the European Commission nevertheless confirmed at the end of 2018 that the EU-US Privacy Shield guarantees an adequate level of data protection. This is not the end of the matter, however, because Mr Schrems has already raised questions about the effectiveness of this new program with the ECJ. Considering that the EU-US Privacy Shield replaced the Safe Harbor Program after the latter was declared invalid, there remains the likelihood that its successor will suffer the same fate, rendering all data transfers on its basis illegal.

EU STANDARD CONTRACTUAL CLAUSES

Last but not least, the EU Standard Contractual Clauses are a popular instrument for the creation of an adequate level of data protection. This type of contract is concluded between a company in the EU and the recipient of the personal data located in an unsecure third country like the USA. While the EU Standard Contractual Clauses cannot be modified, additional clauses can be agreed upon, as long as they do not contradict the EU Standard Contractual Clauses. In response to the ECJ ruling, service providers from the US have started offering their European customers alternatives to the Safe Harbor program in which the EU Standard Contractual Clauses play a central role. It can be complicated to adapt these alternatives to specific cases, however, considering that the EU Standard Contractual Clauses cannot be altered. Conducting a thorough (data protection) legal assessment is therefore advisable before opting for this approach.

Even though some of the reasoning in the CJEU judgment can also be applied to the EU Standard Contractual Clauses, the European data protection authorities consider them to be a suitable

alternative for the Safe Harbor program (and its successor, the Privacy Shield). But, Mr. Schrems struck again. The CJEU heard oral arguments on the 9th July 2019 in case C311/18 to decide about the admissibility of the Standard Contractual Clauses as means of creating an adequate level of data protection for the transfer of personal data. This poses a huge threat to all data transfers to countries outside the EEA, as Standard Contractual Clauses are heavily relied upon for international data transfers outside the EEA. Taking the Standard Contractual Clauses down could lead to dire consequences for data transfers to the US, especially taking into account that there are only very few alternate appropriate safeguards. A decision of the CJEU is expected next year. Until then it remains unclear whether or not these clauses will still be sufficient in the future to ensure an adequate level of protection when transferring personal data to the US. Currently, this alternative to the Safe Harbor program nevertheless appears to be the most viable one.

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The new German Trade Secrets Act in a nutshell – an overview of the new legal system

On 26 April 2019, the German Trade Secrets Act (*Geschäftsgeheimnisschutzgesetz, GeschGehG*) entered into force in Germany. This act implements the European Union Directive (EU) 2016/943 and establishes and implements common European standards for the protection of trade secrets in Germany.

The German Trade Secrets Act (the "Trade Secrets Act") provides for a new civil law foundation for the protection of business and trade secrets. Owners of trade secrets are now awarded statutory remedies, which resemble those of the conventional IP rights, i.e. injunctive relief, delivery up and destruction of infringing goods or, where appropriate, their withdrawal from the market, as well as the right to information. Section 23 of the Trade Secrets Act also stipulates a penal provision, so that the infringement of trade secrets is subject to criminal penalties.

The Trade Secrets Act further introduces new procedural rules for trade secret infringement proceedings which facilitate bringing a trade secret infringement action while safeguarding the trade secret holder's legal interests in keeping the trade secret confidential.

TRADE SECRET – CORE TERM

The core term of the Trade Secrets Act is "trade secret", which is defined in section 2 no. 1 of the Trade Secrets Act as any information,

a) that is not, in the precise configuration and assembly of its components, generally known or readily accessible to persons within the circles that normally deal with this kind of information so that the information therefore has commercial value and

b) that the lawful owner has taken reasonable steps, under the circumstances, to keep secret and

c) for which there is a legitimate interest in keeping confidential.

These three requirements must be met in order for information to be considered a trade secret and be subject to the protection of Trade Secrets Act. Trade secrets can include technical know-how as well as other business secrets, such as customer and supplier lists, business figures, prices, etc. However, the protection does not extend to the practical experience of employees. Former employees cannot be prevented from using and thus disclosing such information; yet, contractual non-compete clauses can provide protection for a limited period of time under certain – strict – conditions.

Perhaps the most important requirement for protection under the Trade Secrets Act is that the owner of the information in question has taken reasonable steps under the circumstances to keep the information secret. What steps are considered reasonable has to be determined on a case-by-case basis. The steps must be reasonable under the respective circumstances. A decisive factor could, for example, be how important the information is for the company. For instance, construction plans for the company's most important product must be better protected than a customer list for a mass-produced article. The size of the company in question and its capabilities with respect to implementing measures to protect trade secrets should – at least according to the explanatory memorandum for the Trade Secrets Act – play a role in evaluating whether the steps taken are considered reasonable and therefore sufficient to award the information protection as a trade secret under the Trade Secrets Act. As a result, it is not only possible, but also necessary to implement a graded system of protection. This requires the identification of the information which is to be protected as a trade secret, as well as the classification of these trade secrets depending on their importance to the company, the type of use of the trade secret and the risk that it will be unintentionally disclosed to third parties, so that adequate technical and legal protective measures can be arranged.

PERMITTED AND PROHIBITED ACTS AND EXCEPTIONS THEREOF

The Trade Secrets Act contains a non-exhaustive list of possible actions that can result in the legitimate obtaining of a trade secret. Naturally, independent parallel or in-house development or creation is permitted. An important change with respect to the legal situation prior to the Trade Secrets Act is that reverse engineering is now generally allowed, when the holder of the trade secret

placed the product in question on the market, thus making it available to the public, or when it is lawfully owned by the person who is performing the reverse engineering, provided that no restrictions, such as through a relevant contractual provision, have been placed on such a lawful owner.

Further, the Trade Secrets Act makes it clear that trade secrets may not be obtained, disclosed or used against the will of the trade secret holder or in violation of a contractual obligation. This includes acts such as unauthorized copying of documents, articles or materials. Those who receive trade secrets from third parties may not use or disclose these secrets, if it is evident that the third party obtained the trade secret without authorisation.

These prohibitions, however, do not apply when, for example, they impede the freedom of expression, the work of the press or the detection of criminal offences. Accordingly, the protection of trade secrets is subsidiary to the ordre public.

RIGHTS OF TRADE SECRET HOLDERS IN CASE OF INFRINGEMENT

The Trade Secrets Act provides trade secret holders with comprehensive and wide-reaching possibilities to prohibit the distribution of infringing products and claim compensation for damages suffered as a result of the infringement of a trade secret. Therefore, the Trade Secrets Act deliberately defines "infringing goods" very broadly. Section 2 para. 3 of the Trade Secrets Act establishes that such infringing goods are those for which the conception, features, functioning, production process or marketing is based, to a considerable extent, on a trade secret, which has been unlawfully obtained, used or disclosed.

To prevent future infringements, the trade secret holder is entitled to injunctive relief against infringers, in accordance with the rights, which apply to other intellectual property rights such as patents, trademarks, or copyrights.

Further, the trade secret holder has a right to request the destruction or return of documents or objects, which contain the trade secret, and to the recall, removal and withdrawal from the market and the destruction of infringing goods. In order to enable trade secret holders to expose infringements, the Trade Secrets Act grants trade secret holders a comprehensive right to information from infringers.

For culpable infringements, the Trade Secrets Act grants trade secret holders a right to claim damages from infringers. To calculate how much should be paid in damages, the injured trade secret holder may choose between three methods of calculation and select the one that is most favourable to him. These methods include compensation for lost profits of the trade secret holder, damages based on a fictitious, reasonable license fee, or claiming the profits of the infringer.

PROTECTION OF TRADE SECRETS DURING INFRINGEMENT PROCEEDINGS

Before the Trade Secrets Act came into force, bringing an action before the courts for the infringement of a trade secret brought with it the risk that the trade secret would have to be disclosed in order to win the case. The Trade Secrets Act addresses these concerns and provides for a number of protective measures available to trade secret holders in trade secret infringement proceedings.

In trade secret infringement proceedings, either party can file a request that the court treat certain information as confidential. The party applying for this treatment must credibly demonstrate that the information in question is a trade secret. If the court recognizes a trade secret, it will instruct the parties, their lawyers, witnesses and experts to treat this information as confidential. In addition, this information may not be used or disclosed outside of the court proceedings. Fines of up to EUR 100,000 can be imposed for failure to comply with these requirements. Further, it is possible to limit access to documents and oral hearings to a set number of trustworthy persons from both parties. Third parties will only be able to access redacted documents.

CONCLUSION

The Trade Secrets Act upgrades the protection of trade secrets, bringing it into line with the special German laws that provide for the protection of intellectual property rights, such as patents, trademarks and copyrights, especially with respect to the rights of trade secret holders against infringers. As a result, trade secret holders now have comprehensive statutory rights under the Trade Secrets Act, allowing them to take action against infringers and recover any damages suffered.

In order to qualify for protection under the Trade Secrets Act, the trade secret holder must carefully handle any information, which contains trade secrets. It is advisable to implement a graded protection scheme, which is tailored to the individual circumstances, and to seek to secure trade secrets against third party use or disclosure through the adoption of detailed confidentiality and use restriction agreements, which have been adapted to the case in question.

The new rules on the protection of trade secrets during infringement proceedings serve to assure trade secret holders that taking legal action against an infringer will not lead to the loss of the trade secret through its disclosure to the infringer and the public.

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The end of flexible working time arrangements? New limits for start-ups?

Working life today is fast-paced. This is particularly true for start-ups, which thrive on the fast pace, creativity and drive of employees and other contributors. This is far from the prevailing image of an eight-hour workday, which ends when you leave the Office.

Thanks to digitalisation, performance is often no longer dependent on presence in an office. The same is true for the flow of ideas. Yet the judgment of the European Court of Justice (ECJ) of 14 May 2019 (Case No C-55/18) could spell the end of this freedom.

FUTURE OBLIGATION TO MONITOR WORKING TIME

Following the judgment handed down on 14 May 2019 (C-55/18), Member States must now require employers to establish an objective, reliable and accessible system, which enables the duration of time worked each day by each employee to be measured.

For start-ups, which often handle the topic of working time very flexibly, this judgment raises numerous questions. The most important of these must be whether the judgment has put an end to flexible working time Arrangements.

STARTING POINT

In many respects, the Working Time Act (*Arbeitszeitgesetz, ArbZG*) is inflexible and no longer suits today's working and working time models. It is no secret that many employees regularly infringe the Working Time Act, in particular the provisions on the maximum number of working hours each workday, on rest periods and on rest time.

This will not always be a case of abuse and reckless employers using an emergency to exploit employees. On the one hand, employees often explicitly want to infringe the Working Time Act. Foreseeably, employees voluntarily work through breaks (infringing the break requirements), in order to be able to finish work earlier. It is difficult to make a clear-cut distinction between work and rest, particularly for start-ups. Differentiating between when one is specifically working and when one is resting or living is often quite difficult in the case of creative activities.

On the other hand, this freedom can also be considered a burden when employees exploit technical advances to demand that constant availability from their employees.

THE CASE BEFORE THE ECJ

The ECJ takes the protection of employees into account in this recent judgment. Without an obligation to document working time (beginning and end of the working time and breaks), it is difficult, if not impossible, to prove infringements of the working time rules. Accordingly, in line with the ECJ judgment of 14 May 2019 (C-55/18), Members States must compel employees to implement an objective, reliable and accessible system, which enables the duration of time worked each day by each employee to be measured.

The action brought by the Spanish union against Deutsche Bank in Spain therefore has a significant impact on current working time practices in Europe. The ECJ held that a system for the verification of compliance with the agreed working time is necessary as without such a system, it would be extremely difficult, if not impossible, for employees to assert their rights.

As in Germany, Spanish law has only required companies to keep a list of the "overtime" that was worked until now. Neither Spain nor Germany impose a general obligation to comprehensively record the working time. In other words, in general the requirement to document working time only starts when more than eight hours have been worked in a working day in Germany.

WHAT CAN WE EXPECT?

For start-ups, this raises the question of whether existing working time models (such as trust-based flex-time) need to be rethought and how the working time of employees can be monitored.

The question of which form such systems for monitoring the working time must take yields some very diverse results. Solutions range from monitoring logging in and out on a computer, to iris scans, which use biometric data to monitor the way in which a computer is being used. Perhaps there is also a chance for (new) start-ups to develop and bring to fruition apps, chips, etc., which provide a lasting and complete record of working time?

There was a huge outcry. Data protection issues are often neglected in current discussions. In addition, proposed solutions often forget that introducing such systems is only half the battle. After all, not all work is done in front of the computer.

SUMMARY

First: keep calm. It is not yet clear how the German legislators will choose to implement the obligation to record working time. Federal Minister for Employment, Hubertus Heil has announced that he intends to find a new statutory rule and see the judgment implemented by the end of 2019. The German Coalition Government's efforts to make working time models more flexible definitely constitute a challenge in this respect. In any case, the ECJ stressed that it is incumbent upon the Member States to adopt the specific terms, taking into account the special features of the activities involved and the size of certain companies. There is still hope that the prophesised setback will fail to

materialise, and that the legislators will bear in mind precisely the situation faced by start-ups.

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"Smiley with a thermometer in the mouth": the "Whats App doctor's certificate"

WhatsApp simplified communication. For (almost) every situation there is a smiley or an emoji. The following combination of smileys and emojis: "*waving hand*," "*nerd face*," "*see-no-evil monkey*," "*face with a thermometer in the mouth*," "*face with a head bandage*," "*hospital*," "*thumb down*," "*tablet*," "*syringe*," "*bed*," "*sleeping face*," and "*house with garden*" means: "Hi Boss, I'm really not well. I am sick and will stay in bed to sleep until I feel better. It is not possible for me to come to work; I'm staying home" in WhatsApp-speak. This might be one way to let your employer know that you are ill. However, would a "WhatsApp certificate of incapacity to work" also be permissible? "*Thoughtful face*."

Over the last few weeks there has been a lot written about the online or WhatsApp certificate of incapacity to work. Since January 2019, you can apply for doctor's certificate for only EUR 9.00 on AU-Schein.de, and will receive the certificate via WhatsApp. The lift of the ban on the remote treatment of patients has made it possible for doctors to treat patients via various communication mediums, without personally seeing and examining them. "*Surprised face*," "*face with a furrowed brow and open mouth*."

EMPLOYEE OBLIGATIONS IN THE CASE OF INCAPACITY TO WORK

Legally speaking, an employee is incapacitated and unable to work in the case of illness when the physical or mental state of the employee is abnormal to the extent that the employee is no longer able to carry our their work or is unable to do so without risking making their illness worse. "*Nerd face*."

The obligations on employees ("*admonishing face*") in the case of incapacity to work due to illness include the duty of disclosure, the obligation to provide proof and the obligation to promote recovery. Pursuant to Section 5 para. 1 first sentence of the German Continuation of Remuneration Act (*Entgeltfortzahlungsgesetz, EFZG*), the duty of disclosure is understood as the need for an employee to immediately inform their employer of their incapacity for work and the foreseen duration of that incapacity. There is no form requirement, so that this information may be provided via the telephone, email or WhatsApp. The obligation to provide proof is the obligation to provide a doctor's certificate, in accordance with Section 5 para. 1 second sentence of the EFZG.

REQUIREMENT TO PROVIDE A VALID DOCTOR'S CERTIFICATE

When the employee is unable to work for more than three days due to illness, the employee has the statutory obligation to present their employer with a doctor's certificate on the next workday at the latest (§ 5 (1) second sentence of the EFZG). The medical certificate must be issued by a licenced physician. The certificate must state the name of the employee as well as the start and foreseen duration of the incapacity to work due to illness. The certificate must also state when the doctor determined that the employee was unable to work, and whether the certificate is the first one issued by the doctor for the employee in this instance or whether it is a subsequent certificate. If even one of these requirements is missing, the doctor's certificate will not be valid. In line with data protection rules, the certificate should not state the illness diagnosed by the doctor.

UNDERMINING THE EVIDENTIAL VALUE OF A DOCTOR'S CERTIFICATE

When an employee is incapacitated and unable to work due to illness, they are released from their obligation to work. In contrast, the employer must continue to pay the employee for up to six weeks; this is an exception to the general principle of "No pay without work" (Section 3. para. 1 of the EFZG). "S*miley with dollar signs in its eyes*."

The employee has the burden of proof with respect to the requirements for the continued payment of their remuneration and thus for providing evidence of their incapacity to work due to illness. Normally, this requirement will be satisfied by presentation of the doctor's certificate. Doctor's certificates have a very high evidential value in Germany. However, where there are serious doubts, the probative value of such certificates can be questioned. This can happen, for example, when the doctor's certificate is issued only after talking to a physician on the telephone; when the doctor's certificate is back-dated; when the employee announced in advance that they were going to be sick; when the employee is often sick after the end of their holidays or leave, or just before or just after the weekend or public holidays or on bridging days; or where the employee does something during their leisure time that is inconsistent with the doctor's certificate. Undermining the doctor's certificate leads to the employee having to prove his inability to work – without the doctor's certificate.

THE WHATSAPP DOCTOR'S CERTIFICATE "SURPRISED FACE," "FACE WITH FURROWED BROW AND OPEN MOUTH"
It is no secret that it is "very easy" to convince some doctors that they need to issue a doctor's certificate – despite the high probative value of such certificates. Will it now be even easier to get a doctor's certificate – online – while sitting on your couch? "*Exploding smiley*," "*bright red face with profanity signs over the mouth*."

The aim is to simplify the obligation to provide proof – at least when you have a cold, "*sneezing face*" – by allowing a "tele-doctor" to issue a doctor's certificate via WhatsApp, e.g. through "AU-Schein.de". The employee answers questions on an online portal about the state of his or her health or illness and is then issued a – maximum three-day – doctor's certificate. Before the doctor's certificate is issued, the employee's answers to the questions about the state of their health are checked, supposedly by a doctor – at least this is the legal requirement for the issue of a doctor's certificate. On the same day, the employee will receive the doctor's certificate via WhatsApp to show their employer and the original will arrive two days later in the post. Ultimately, the validity and probative value of an online doctor's certificate are not yet clear. In any case, there are not yet any court decisions on this issue.

Employers, who have doubts about an employee's illness, about the illness causing an incapacity to work and/or about the online doctor's certificate, can call the probative value of the online doctor's certificate into dispute, just like they can with any other doctor's certificate. The employer could raise significant questions in relation to the probative value of the online doctor's certificate based, for example, on the fact that such online services offer to back-date certificates by up to three days, despite the fact the courts have repeatedly held that back-dating doctor's certificate raises doubts about an employee's supposed inability to work. The evidentiary value of an online doctor's certificate can also be called into question due to the fact that such online services advertise that their patients are 100% guaranteed to receive a doctor's certificate. In practice, patients who actually visit their doctor are likely to be issued a doctor's certificate for a longer period. However, a 100% rate of doctor's certificates can still infringe the principles of medical ethics.

Whether the online doctor's certificate via WhatsApp will catch on remains to be seen, as does its legal validity.

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A word about Vesting

One of the central provisions of any investment and participation agreement is the vesting provision. Despite their importance, we see many such provisions, which work for neither the founders nor the investors and which rely on customary terminology, but use this terminology incorrectly. That is why it is time for "A word about Vesting":

SENSE AND PURPOSE OF VESTING
The founders are the real assets of any start-up. They developed the business idea and should naturally continue to develop this idea after one or more investment rounds.

It is a major disaster for any start-up and thus for any investment in a start-up when a founder – for whatever reason – is no longer involved or no longer wants to be involved in the day-to-day business of the start-up. It is therefore crucial – not only for investors, but also for founders – that there is a link between a founder's position as a shareholder on the one hand and their role in the day-to-day business of the start-up on the other. Vesting provisions will do this. Ideally they will be agreed between the founders when establishing the company and every investor will insist on such vesting provisions.

The basic function of a vesting provision is easy to explain:

LEVEL 1: For the case that one of the founders ceases his active role in the operative business of the start-up during an agreed vesting period, the founder will offer to transfer his shares (in whole or in part) to the company, the investors and/or the remaining shareholders in exchange for *vesting consideration* in accordance with the shareholders agreement. In addition, with the exception of investments made at very early phases of the start-up, it is generally agreed that the number of shares, which are subject to vesting, will reduce over the *vesting period*. This will generally be a linear progression in agreed steps (e.g. monthly or quarterly steps), while a cliff period is normally agreed for early financing rounds, which initially postpones the linear reduction. If a founder repurchases (all or some of) his shares over the vesting period, these are "*vested shares*". The vested shares are excluded from the initial transfer offer. Accelerated vesting is when it is agreed that all shares become "*vested shares*" in the case of an exit.

LEVEL 2: The differentiation between a good and a bad leaver introduces a second level into the vesting provision. While a good leaver has left the start-up for reasons that are not his fault, the bad leaver stole the "silver spoon" and is responsible for the reasons for his exit. On this basis, the good leave receives a settlement, based on market value, and the bad leaver receives a settlement based on the book value of the shares.

However, it starts to become confusing when level 1 and level 2 are blended: regularly, this will involve the variant in which a bad leaver has to relinquish all shares, including the vested shares upon exit. While this rule is rather harsh for the founders, the risks are predictable as long as good and bad leavers are clearly defined. In contrast, the terminology is incorrect when vesting provisi-

on speak of vested shares but do not properly "vest" those shares and instead merely defer the amount of the settlement over the vesting period. In such cases, experienced advisors should to advise the founder of the actual function of a vesting provision and, where necessary, correct the provisions.

In addition to these conceptual inaccuracies, too little energy is often invested in the legal effects of any vesting provisions. A case of vesting can frequently see a start-up skate into a real crisis where the start-up is not able to afford the transfer of the surrendered shares even at book value. It is therefore particularly important to ensure that the respective founder can be paid their settlement in numerous instalments that are as low as possible, and that the shares can lose their voting rights, regardless of the payment of the settlement.

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