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Federal Government introduced stricter rules on German foreign investment control – Berlin Wall rebuilt?

Amendment of the German Foreign Trade and Payments Ordinance (AWV)

An amended regime on foreign investment control came into force on 18 July 2017, introducing stricter rules on German foreign investment control.

Background

Being an export economy, Germany generally embraces the principle of free trade, and it is, in principle, also open to foreign investment. Recently, however, with the much publicised take-over of the Airbus Defence Electronics Unit by American hedge fund KKR, and critical media coverage surrounding a potential acquisition of Kuka and Aixtron by Chinese investors, the political debate heated up regarding potential take-overs by foreign entities of domestic companies, as it was feared that such acquisitions will lead to transfer of core technologies and know-how abroad.

On 12 July 2017, the Federal Government adopted an amendment of the Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung, “**AWV**”), and strengthened the rules on foreign investment control. The amendment broadens the fields of application for foreign investment control by the Ministry for Economic Affairs and Energy (Bundeswirtschaftsministerium, “**BMWi**” or the “Ministry”), which will presumably lead to more M&A transactions being reviewed by the Ministry. Moreover, various deadlines with regard to potential examination procedures have been prolonged, giving the BMWi more time to deal with acquisitions by foreign buyers, and to deliberate whether and to what extent to take measures in their respect. The amendments came into force on 18 July 2017.

Extension of the scope of foreign investment control

Under the German rules of foreign investment control, the BMWi may conduct a so-called “**cross-sectoral investment review**” of an acquisition which is applicable irrespective of the industry sector the target company operates in (cf. sections 55 - 59 AWV). Specific rules apply, however, to the acquisitions of certain military, defence and IT security companies (so-called “**sector-specific investment review**”, cf. sections 60 - 62 AWV).

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Cross-sectoral investment review

Within the framework of cross-sectoral investment review, BMWi already had the competence to (potentially) examine the acquisition of a domestic company by a foreign buyer. As part of such an examination, it had to establish whether the acquisition (or the direct or indirect acquisition of at least 25% of the voting rights) endangered the “public security and public order” (*öffentliche Ordnung oder Sicherheit*) of the Federal Republic of Germany. In case of an actual threat to public security, the Ministry had, in theory, the authority to take measures to mitigate this threat, or even prohibit the transaction.

Introduction of catalogue of industry sectors

The amended AWV introduces for the first time a catalogue of industry sectors where the acquisition by a foreigner is by law considered to be a potential threat to public security. The catalogue lists, for example, sectors such as information technology and telecommunications (e.g. cloud computing services). And there is a special focus on the protection of companies that operate so-called critical infrastructures (*Kritische Infrastrukturen*), or develop software for such infrastructures. Such critical infrastructures are, according to the AWV, *inter alia*, water and energy supply, health and nutrition, financial institutions and insurance as well as freight and passenger transport.

The introduction of the catalogue indicating examples of a potential threat to the public authorities constitutes a shift in the concept of assessing acquisitions, and it is to be expected that such acquisitions will from now on be more thoroughly examined by the Ministry. Irrespective of the catalogue, however, the BMWi still has to decide on a case-by-case basis whether the acquisition *actually* endangers public security (e.g. by assessing the size and the relevance of the company to be acquired). Please also note that the catalogue of sensitive industry sectors is not exhaustive, so despite the catalogue, any other transaction may potentially fall under the scope of foreign investment control if the BMWi deems it a danger to the public order and security of Germany.

Notification obligation

Upon signing of the SPA, the purchaser is obliged to notify the acquisition of a company active in a listed sector to the BMWi. This stands in contrast to the legal situation as it was up until now, where such notification was on a purely voluntary basis, unless the target companies operated in the military and IT security sector (and it remains voluntary regarding acquisitions of companies not active in one of the listed sectors).

Sector-specific investment review

Further, the scope of the sector-specific investment review was also amended. Under this investment control regime, the German government has comparatively wide discretion to prohibit an acquisition, and the buyer has a notification duty vis-à-vis the BMWi regarding such acquisitions. Previously, such review was only possible, where domestic companies manufactured and/or developed (i) war weapons, (ii) battle tanks and other armoured military tracked vehicles as well as (iii) security-relevant IT products. With the amendment, this catalogue was further extended to include companies which

manufacture other sensitive military items, such as, *inter alia*, target devices, drones, flight simulators, military purpose camera technology, as well as construction and maintenance equipment for such military applications. In respect of companies operating in these areas, the investment control rules remain not only applicable to acquisitions by non-EU-foreigners, but also to EU/EFTA investors.

Extension of time limits of the examination proceedings

In addition, certain time limits and deadlines are being extended regarding both cross-sectoral as well as the sector-specific investment review. Consequently, BMWi will have more time to examine a case and to consider whether it should take measures.

For example, under the old regime of cross-sectoral review, if a company was to be acquired, the BMWi could only deal with an acquisition if it initiated a formal examination within three months after the signing of the SPA. Now, the expiry period for such *ex officio* examination still amounts to three months, but it only starts after the BMWi gains *positive knowledge* of the acquisition. If the acquirer cannot prove that the BMWi gained knowledge of the transaction, the BMWi may, under the new rules, retroactively start an examination for up to five years after the transaction (signing).

Also, the periods within which the BMWi may take measures after initiating a formal investigation into an acquisition have also been extended. Within the cross-sectoral review procedure, they are now four months instead of two months after the receipt of all relevant documentation; in a sector-specific examination, they are three months instead of one.

For investors, the new rules lead to considerable uncertainty regarding the time-frame for a successful closing of the transaction. Foreign investors should therefore be prepared to accommodate for the longer periods for foreign investment control. Moreover, the potential uncertainty will also, in our view, increase the relevance of clearance certificates as a risk mitigation option (see below).

Increased relevance of so-called clearance certificates

With the so-called “clearance certificates” (“*Unbedenklichkeitsbescheinigung*”), the AWV already provides a tool for a foreign investor to obtain legal certainty regarding an envisaged transaction. Investors can (informally) apply for such a certificate by notifying the BMWi about the planned transaction. Also with regard to this instrument, the amendment of the AWV now provides for longer periods of deliberation for the BMWi: after notification, the BMWi has to decide within two months (instead of one month) whether it launches a formal investigation procedure, or whether it issues the requested certificate. In case the BMWi does not react within two months, there is a legal fiction that the Ministry does not object to the acquisition.

Clearance certificates are an established route if it cannot be ruled out that the acquisition may be considered a threat to public security (i.e. in most

transactions where the target operates in sensitive areas). Obtaining clearance from the BMWi is thus a closing condition in many SPAs, where a foreign investor intends to acquire a Germany based company. In view of the legal uncertainty that may linger over an acquisition if no notification of an envisaged acquisition is made (i.e. the BMWi may pick up on such a transaction up to five years after signing), we expect that clearance certificates will play an even more important role in the future.

Summary and outlook

All M&A transactions signed as from 18 July 2017 which are subject to either the cross-sectoral investment review or the sector-specific investment review are falling under the amended regime of the AWV and there is ground to suspect that the amendments will have a negative overall impact on such transactions. In particular, the extended time limits of the examination proceedings lead to legal uncertainty for the parties. Therefore, in transactions where a foreign buyer targets a German company, it will become even more important to take precautionary measures with a view to foreign investment control. Clearance certificates and related precautions in SPAs (such as incorporating the approval of the BMWi as a closing condition) will have increased relevance to mitigate such legal uncertainty.

Precautionary measures should be taken in particular in view of investments in companies that are active in the newly listed industry sectors, such as energy and transport. Such investments now have to be expressly notified to the BMWi, and it is to be expected that they will be examined more thoroughly and intensely by the Ministry. Investors should thus be prepared to accommodate for these longer periods in their acquisition time frames.

With a view to the current political situation in Germany the amended regime of the AWW seems to send the wrong signal. While the German government vouched for free trade on the G-20 summit in Hamburg only two weeks ago, Berlin Walls are now being built attempting to protect the German economy. The amendment of German domestic legislation also runs contrary to the recent European initiative brought forward by Berlin, Paris and Rome pushing for EU-wide rules to limit takeovers in sensitive industries by companies from non-EU countries. However, such initiative was given only a very cautious welcome by the EU.

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This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

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