FROM TOOTHLESS TIGER TO APEX PREDATOR? AN OVERVIEW OF THE EFFECTS OF THE GERMAN INVESTMENT CONTROL IN ACCORDANCE WITH THE FOREIGN TRADE AND PAYMENTS ORDINANCE (AUßENWIRTSCHAFTSVERORDNUNG)

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A. FROM TOOTHLESS TIGER TO APEX PREDATOR? AN OVERVIEW OF THE EFFECTS OF THE GERMAN INVESTMENT CONTROL IN ACCORDANCE WITH THE FOREIGN TRADE AND PAYMENTS ORDINANCE (*AUßENWIRTSCHAFTSVERORDNUNG*)

Kuka, Aixtron, and Osram Licht (Ledvance) — all well-known examples of successful or last-minute prevented takeovers of German companies by Chinese investors. These frequently discussed transactions are not isolated cases. To review and even prohibit takeovers of German companies by foreign investors, the federal government has, since 2009, the so-called "investment control" option.

That investments from abroad are considered as critical by the Federal Ministry for Economic Affairs and Energy (*Bundesministerium für Wirtschaft und Energie*) ("FMEE") in certain cases became public in July 2018 when the Chinese state-owned State Grid Corporation of China wanted to take over a 20% stake in the German transmission system operator 50Hertz. At the insistence of the German federal government, the Reconstruction Credit Institute (*Kreditanstalt für Wiederaufbau*) ("RCI") finally took over the 20% stake and thus thwarted the planned takeover. Subsequently, the FMEE issued a first prohibition vote on the basis of the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung*) ("FTAPO") when French company Manoir Industries, which is controlled by the Chinese Yantai Taihai Corporation, intended to acquire Westphalian company Leifeld Metal Spinning AG.

Because of last year's tightening of FTAPO regulations, in particular in terms of notification obligations and interpretation, the possibilities for control have significantly changed and now provide a sharper sword for the examination of foreign investments (see our News Alert of December 2017). This is not intended to create any new protectionism. The aim, according to Federal Minister for Economic Affairs and Energy Peter Altmaier, is rather "[...] that companies continue to invest in Germany." The federal government reserves the right to have a

say only in exceptional cases. How this is currently handled in practice is briefly explained below.

B. EXAMINATION REGIME OF §§ 55–62 FTAPO

To illustrate the two cases mentioned above, the following is a brief outline of the FTAPO regime.

FTAPO regulations on company acquisitions distinguish between cross-sector review and sector-specific review, with the latter only taking place in very specific, particularly security-relevant areas.

In both cases, all decisions of the FMEE vis-à-vis the applicant are to be qualified as administrative acts, which in turn can be challenged before the administrative courts. Since there is no special jurisdiction, the first instance is always the Administrative Court of Berlin.

I. Cross-sector Review

The more practice-relevant cross-sector investment review affects company acquisitions by players domiciled outside the European Union ("EU") or outside the European Free Trade Association ("EFTA") region that result in the acquisition of at least 25% of the voting rights in a German company.

The examination standard of the FMEE is the endangerment of public security and order. According to § 55 para. 1, sentence 2, no. 1, FTAPO for example, such a threat can be assumed if the German target company is the operator of a so-called "critical infrastructure" within the meaning of the law in the Federal Office for Information Security (*Bundesamt für Sicherheit in der Informationstechnik*). These include, for example, the sectors of energy, information technology and telecommunications, transport and traffic, health, water, and nutrition, as well as finance and insurance. However, the mere fact that a company belongs to one of these sectors is not sufficient. The facilities must also be important for the functioning of the community, so that their failure or impairment would result in significant supply bottlenecks or threats to public security.

According to § 55 para. 1, sentence 2, no. 2–5 FTAPO, the review is also required if the target company produces software for the above-mentioned areas.

The examples of § 55 para. 1, sentence 2 FTAPO added by the new regulation of the FTAPO in 2017 are intended to fill in and make concrete the phrase "public security and order" without extending the scope of the regulation too far. In any case, it should be

noted that the examples given are not exhaustive. The FMEE therefore continues to have a wide margin of judgement.

Furthermore, the FMEE is only entitled to carry out its review if the purchaser has its registered office outside the EU or outside the EFTA region, which are treated equally.

The review is also carried out when the acquisition is made by an EU resident but there are indications (e.g., due to the ultimate shareholder being a foreign investor) that the acquisition is made by an EU resident acquirer to circumvent the review procedure. What is new here is that the intention of circumvention must not be the sole motive for the acquisition through an EU resident, but it must at least be one of the motives. As an indication of such circumvention, it is explicitly noted, by way of example, that the immediate acquirer has not yet engaged in any significant economic activity or does not maintain a permanent presence in the EU (or EFTA) in the form of business premises, staff, or equipment.

Accordingly, when strictly reading the provisions of the FTAPO, acquisitions made by EU-based purchasers may only be subject to the review process if the prerequisites of abuse or circumvention are met. Given the German official investigation principle (*Amtsermittlungsgrundsatz*), it is the FMEE that must, in principle, independently review or determine the actual prerequisites under which such an abuse or circumvention transaction exists.

Having said this, however, in regard to the case of Leifeld Metal Spinning AG, it becomes apparent that in cases of indirect share acquisitions, contrary to the wording of the FTAPO, it cannot be ruled out that the FMEE directly focuses on the ultimate non-EU shareholder behind the actual (EU resident) acquirer and commences the review process even without having any indication of abuse.

According to the new regulations, the parties involved in the transaction are now required to notify the FMEE if the transaction relates to a critical infrastructure in the meaning described above. If the parties fail to comply with their notification obligation, the FMEE has the right to review the transaction within a period of five years upon signing. After the five-year period has expired, a review is no longer possible.

If the FMEE is notified, the transaction is deemed to be cleared if the FMEE does not take any action within three months after having obtained knowledge of the transaction.

The actual review period is four months after receipt of the complete documentation.

The result of the examination can either be the prohibition or the approval of the transaction (possibly subject to certain conditions).

One way of avoiding the complex review procedure is to apply for a legally binding no-objection/white-wash letter prior to the signing of the transaction. The FMEE will then have two months (instead of one month) after the filing of the application to examine the application. The FMEE is permitted to initiate an examination procedure within the two-month period with the deadlines specified above. From a practical point of view, the extension of this deadline to two months is unfortunate, as there is no longer any synchronization with the monthly deadline under the merger control regime.

If the FMEE does not reach a decision within this time frame, the transaction is deemed to be cleared. Against this background, even if the FMEE initiates a review within the two-month period with the deadlines specified above, the application for a no-objection/white-wash letter at least prevents the initial three-month period.

Accordingly, the application for a legally binding no-objection/white-wash letter is a practice-relevant possibility to obtain a somewhat faster and legally secure decision.

II. SECTOR-SPECIFIC REVIEW

The sector-specific review follows the same structure as the cross-sector review.

In contrast to the cross-sector review, however, the material scope of the sector-specific review is conclusively regulated in the FTAPO. This mainly affects companies in the production of weapons of war as defined in Part B of the War Weapons List, engines or transmissions for the propulsion of battle tanks or other armored military tracked vehicles, or the manufacture of products or components with information technology security functions. The scope of the new regulation has been extended to include certain items from Part 1, Section A of the Export List.

The sector-specific review affects not only non-EU and non-EFTA members but also all foreigners, including EU residents.

The above deliberations regarding circumvention transactions apply here accordingly.

In addition, the approval of a transaction in the military-specific sector is now deemed to have been granted if the FMEE does not decide to initiate the review within three months after receipt of the documents. In contrast to the cross-sector review, however, there is no maximum period after the expiration from which a review by the FMEE is excluded.

The actual review period is, in contrast to the cross-sector review, three months after receipt of the complete documentation.

III. Practical Implications

The examples mentioned at the beginning of this article well illustrate the practical effects of these regulations. When the RCI prevented the acquisition of a 20% stake in 50Hertz it became obvious that investment control is now a strong instrument to exert influence on the intended shareholder structure when selling key technologies or a critical infrastructure. Although in this specific case no measure by the FMEE based on the FTAPO was taken (the 25% threshold not having been reached), the interest of the federal government in reviewing foreign investments under security policy considerations is rather apparent.

Shortly thereafter, the first direct case of application of FTAPO regulations became publicly known when the intended acquisition of the Westphalian company Leifeld Metal Spinning AG by the Yantai Taihai Corporation was stopped. As indicated above, it is fair to say that the FTAPO is currently not only understood as a legal instrument but also as a political one. The Chinese investors had already given up their intention to purchase Leifeld Metal Spinning AG prior to the expected formal prohibition of the acquisition by the FMEE and had withdrawn their application for a no-objection/white-wash letter, so a prohibition by the FMEE was de facto no longer necessary. Nevertheless, the FMEE subsequently issued a prohibition vote.

As a result, it can be stated that the investment control regime under the FTAPO is not only a theoretical one but applies in practice. In particular, the new notification requirement for acquisitions of at least 25% of the voting rights of a company in the area of critical infrastructure results in the FMEE being informed of planned investments at an early stage. Failure to comply with the notification obligation is hardly to be expected, as otherwise the five-year period outlined above would apply. The risk of the FMEE prohibiting a transaction subsequent to its closing will rarely be taken by an investor.

C. CONCLUSION/OUTLOOK

If one looks to the future, it becomes clear that further decisions against foreign investments can be expected — assuming that the aforementioned specific requirements are met. This is made clear by the announced further tightening of FTAPO regulations. The threshold for the initiation of a review procedure is expected to be lowered from 25% of the voting rights to 15% in the near future.

The fact that Germany is not alone in further tightening its investment control is shown by the fact that France, Great Britain, and the United States are also planning or have already implemented further tightening of their existing regulations. There are also efforts at the EU level to create a legal framework for the control of foreign investments, especially in the areas of critical infrastructures and sensitive technologies.

In the United States, for example, the prohibition of transactions is already possible with a simple reference to national security interests; the potential application spectrum of investment control is therefore much broader. Due to recent amendments, it is now even possible to review the acquisition of minority interests of any kind in U.S. companies by foreign investors, including participations in U.S. companies via foreign venture capital funds.

And finally, China in many cases only allows the setup of joint ventures (together with a Chinese joint venture party) so to ensure sufficient domestic influence right from the beginning.

For the time being, transaction practice will have to accept the fact that a more generous timetable for planned investments will have to be taken as a basis for the investment review to be carried out in individual cases. In order to mitigate the risk of resulting legal uncertainty, it would make sense to make the decisions of the FMEE, which are currently not publicly available, more transparent overall. In particular, guidelines on the interpretation of certain terms or the handling of deadlines could help.

In order to minimize risks and delays, it is strongly recommended to apply for a no-objection/white-wash letter for affected transactions and to be as transparent as possible in the subsequent procedure.

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