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Impact of Foreign Investment Control on M&A in Germany

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1. Introduction

In November 2018, the European Parliament, the European Council and the European Commission reached a political agreement on an EU framework for screening foreign direct investment. The European Union (EU) intends to ensure the protection of “[...] *their essential interests while remaining one of the most open investment regimes in the world.*”¹. Regulation (EU) 2019/452 of 19 March 2019² (the “**EU Regulation**”) implemented this agreement.

Based on a proposal initiated by Germany, Italy and France in 2017, the EU is responding to the controversial debate on free trade and investment versus protectionism in the context of Cross-Border M&A transactions at a European and German level. Within EU Regulation’s new framework, the EU Member States and the European Commission will be able to share information and concerns about certain proposed acquisitions, especially if the investment might affect an EU Project or Programme of Union-wide importance. The cooperation mechanisms necessary for the full application of the EU Regulation should be established by 11 October 2020.

While the US Committee on Foreign Investment in the United States (CFIUS) initiates more interventions than ever, the new political views by President Trump’s administration lead to progressive acquisition prohibitions. Only last year the Foreign Investment Risk Review Modernization Act (FIRRMA) reformed and modernized the CFIUS review

¹ European Commission – Press release, Brussels, 20 November 2018.

² REGULATION (EU) 2019/452 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union.

process by representing the first update to the CFIUS statute in more than a decade.

The Chinese government has recently been anxious to prevent irrational oversea purchases. The governmental intentions are now more intended to stop capital outflow, strengthen the national currency and gain access to further resources than to advance reciprocal instruments. This change of attitude led to a decrease of foreign investment by Chinese companies.

Meanwhile, the German government has been concerned about foreign investments in critical and high-tech industries. As part of the EU initiative, Germany called for more reciprocity. With the amendment of the German Foreign Trade and Payments Act (*Außenwirtschaftsgesetz – AWG*) of 20 July 2017 as well as the German Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung – AWW*) of 29 December 2018 the German legislator changed important foreign investment rules.

2. German Foreign Investment Regime

After the reform in December 2017 – aimed to specify the “[...] *national investment investigation law against the background of German security interests.*”³ by, especially with regard to the increase in complexity of international transactions, extending the investigation competence, introducing further reporting obligations and lengthening the assessment period –, the German Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung – AWW*) has been amended to take account of the particular safety relevance of companies operating certain civil security infrastructure services.

The conditions of the competent Federal Ministry for Economic Affairs and Energy (*Bundesministerium für Wirtschaft und Energie*) (the “**Ministry**”) to review the intended transaction depends on the target entity’s business.

a. Sector specific review (*Sektorspezifische Prüfung*)

If a proposed acquisition of at least 10 % of the voting rights in a company in a specific business sector – in particular in connection with certain goods of war and other weapons, goods connected to drive systems of tanks and IT security functions for national security items – by a non-German buyer threatens material national security interests of

³ Bundestag document (*Bundestag-Drucksache – BT-Drs.*) No. 18/13417 of 25th August 2017, p. 1.

the Federal Republic of Germany, the Ministry may review the transaction. Parties are required to notify the Ministry of such an acquisition. The Ministry may prohibit the acquisition within three months from notification if it is required to protect material national security interests. This three months period may be interrupted by negotiations between the Ministry and the transaction participants. If the Ministry remains silent, the acquisition is deemed cleared after three months from notification.

b. Review across all sectors (*Sektorübergreifende Prüfung*)

The Ministry may review an acquisition in a domestic company by non-EU/EFTA buyers to avoid risks for public order or security if the acquired voting rights reach a certain threshold.

If the target entity is involved in one of the following businesses, the threshold of the acquired voting rights is 10 %:

- operating critical infrastructure, i.e. certain companies in the energy, information technology and telecommunications, transport, health, water, food or finance and insurance sector, which are of major importance for the functioning of the community because their failure or impairment would cause significant supply shortages or threats to public security;
- developing software for critical infrastructure;
- being active in or having knowledge of organisation measures or surveillance of public telecommunication systems;
- providing certain cloud-computing services;
- being authorised to provide telematics components or services in certain areas of the health sector; or
- being a media enterprise which contributes to public opinion formation by means of broadcasting, teledmedia or printed matter and is characterised as particularly topical and of broad impact.

If the German target entity is not involved in such a business, the Ministry may review the acquisition of at least 25 % of the voting rights.

If there are no objections, the Ministry shall, upon written application, certify to the purchaser that the acquisition is not objectionable to the acquisition with regard to public order or security. The certificate of non-objection (*Unbedenklichkeitsbescheinigung*) shall be deemed to have been issued if the Ministry does not open an investigation procedure within two months of receipt of the application.

The Ministry may only review an acquisition within three months from being made aware that the contract has been signed. Regardless of the Ministry's knowledge of the transaction no review is possible after five years, however, the conclusion of the contract must be reported to the Ministry. The Ministry may decline the transaction or issue proceedings within four months from receipt of all information, but only with the consent of the Federal Government. This four months period may be interrupted by negotiations between the Ministry and the transaction participants.

3. Impact on historic M&A Transactions in Germany

a. RWE DEA / LetterOne

When Russian investment company Letter One signed a contract to acquire RWE DEA, it applied for certificate of non-objection. The minister of economics required a more indepth investigation of the case during a two month period. Af ther review of the transaction the administiration cleared it. However, the UK's Department of Energy & Climate Change (DECC) requested that part of the deal encompassing twelve producing North Sea oil and gas fields currently owned by RWE DEA should not be approved because “[...] *the effect that possible future sanctions imposed on LetterOne may have on the continued operation [...]*.” of the fields. The acquisition comprises the UK's oil and gas business. In case “[...] *the proposed acquisition were to proceed in its current form, [Ed Davey, DECC's secretary of state] would be minded to require the companies to arrange for a further sale to a suitable third party [...]*.” Despite these concerns the transaction was closed.

b. AIXTRON / Fujian Grand Chip Investment Fund

At the end of the term of acceptance in November 2016, approximately 77 % of AIXTRON SE's shareholders accepted the voluntary public takeover offer by Grand Chip Investment GmbH, an affiliate of the Chinese investment fund Fujian Grand Chip Investment. On 2 December 2016, former President of the United States, Obama issued an Executive Order⁴ prohibiting the takeover on the recommendation of the CFIUS committee. In accordance with this Order, “*the national security risk posed by the transaction relates [...]* to the military

⁴ Presidential Order -- Regarding the Proposed Acquisition of a Controlling Interest in Aixtron SE by Grand Chip Investment GMBH of 2 December 2016.

applications of the overall technical body of knowledge and experience of Aixtron [...] and the contribution of Aixtron's U.S. business to that body of knowledge and experience"⁵. Furthermore, the Orders' argument notes the Chinese state participation in the acquisition vehicle Grand Chip Investment GmbH and the partial financier Sino IC Leasing Co., Ltd.. There is press speculation claiming the decision was based on gallium nitride being an ingredient in an AIXTRON product.

As a result of information given by the U.S. authorities regarding the possible military use, the Ministry revoked the clearance certificate and announced the readmission of the investigation procedure pursuant to the German Foreign Trade and Payments Act (*Außenwirtschaftsgesetz – AWG*) and the German Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung – AWW*).

c. KUKA / Midea

Similarly, the acquisition of KUKA Aerospace Holding LLCs U.S. aerospace sector by the Chinese Midea concern in the second half of 2016 was conditional on the positive decision by the CFIUS committee. In contrast to the attempted acquisitions mentioned above, the committee permitted the sale at the time. Midea had given wide ranging employee and site warranties which seemed to have appeased the minds of the authorities at the time. A few years later the administration seems to regret to have permitted the sale. Early signs that the high purchase price paid by Midea for Kuka was based on the intention to relocate the business to China after a certain period of time after completion of the transaction. This case was a driver for the change in law.

d. 50Hertz / State Grid Corporation of China

In July 2018, the aspirations by State Grid Corporation of China (SGCC) to acquire the German transmission system operator 50Hertz finally failed. SGCC's first attempt, in March 2018, failed after Belgian grid operator and 60 % shareholder of 50Hertz's top holding company Eurogrid International SCRL Elia triggered its option right to acquire 20 % of the shares of 50Hertz. Due to 50Hertz's critical infrastructure business, operating around 10,000 kilometers of power grid in northern and eastern Germany which supplies more than 18 million people, the

⁵ Statement on the President's Decision Regarding the U.S. Business of Aixtron SE, 2 December 2016.

German Government welcomed Elia's decision and thereby State Grid's loss. Then, in July 2018, the German state development bank *Kreditanstalt für Wiederaufbau (KfW)* participated (acquiring 20 % of the entity's voting rights) at the request of the German Federal Government in order to prevent SGCC's second acquisition attempt. The Government then opted to intervene through KfW, since the Ministry was not able to decline the transaction pursuant to German foreign investment law's old threshold value of 25 % of the voting rights, which was the threshold at the time. Following these events, German law on foreign investment control was changed and as described above, in many cases the new threshold is now 10 %.

e. Leifeld Metal Spinning / Yantai Taihai Corp & Manoir Group

In December 2018, Chinese Yantai Taihai Corp & Manoir Group abandoned its efforts to acquire German Leifeld Metal Spinning. The Westphalian traditional manufacturer of special machines and high strengths materials builds, amongst others, machines for the production of parts and materials for the aerospace and nuclear industry. Nuclear businesses running Yantai Taihai Corp & Manoir Group withdrew the application for a certificate of non-objection (*Unbedenklichkeitsbescheinigung*) submitted to the Ministry after the German Federal Government voiced security concerns openly considering to veto the transaction.

4. Outlook

While the Chinese and U.S. governments might prospectively pursue a more domestic focused strategy, the European Commission aims to face the approaching globalization-induced challenges and strike a balance between continuous attractiveness for foreign investors and the opportunity to prohibit acquisition of European companies by state-controlled investors. It can be assumed that more political influence will be exerted on M&A transactions in the critical high-tech and infrastructure sectors.

However, the new EU Regulation stipulates certain requirements for the control of foreign investment for EU Member States which are willing to maintain or implement a review mechanism at national level. Although the Member States are obliged to notify their national investment review mechanism to the European Commission, the decision whether to authorize or prohibit domestic acquisitions remains with the Member State concerned.

The new legislation in Germany affects the planning and implementation of M&A acquisitions in certain specific sectors and can lead to increasing expenses for the purchaser and its consultants. Due to the reporting obligations, the examination work in the planning phase increases. The lengthened investigation period must be considered and early involvement of the Ministry might be advisable. In addition, a detailed preliminary proceeding can accelerate the acquisition and prevent a subsequent block by the governmental investigation. On the basis of a diligent risk assessment careful consideration is to be given as to if and how to implement conditions for foreign investment control clearance in the acquisition documentation. This is in particular relevant in auction processes if the bidder you are advising may be subject to foreign investment control whilst other bidders may not face the same issue if, for example, they come from within the European Union.

Endnotes

- 1 European Commission – Press release, Brussels, 20 November 2018; available at http://europa.eu/rapid/press-release_IP-18-6467_en.htm.
- 2 REGULATION (EU) 2019/452 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union; available at <https://eur-lex.europa.eu/eli/reg/2019/452/oj>.
- 3 Bundestag document (*Bundestag-Drucksache – BT-Drs.*) No. 18/13417 as of 25th August 2017; available at <http://dip21.bundestag.de/dip21/btd/18/134/1813417.pdf>.
- 4 Presidential Order -- Regarding the Proposed Acquisition of a Controlling Interest in Aixtron SE by Grand Chip Investment GMBH of 2 December 2016; available at <https://obamawhitehouse.archives.gov/the-press-office/2016/12/02/presidential-order-regarding-proposed-acquisition-controlling-interest>.
- 5 Statement on the President’s Decision Regarding the U.S. Business of Aixtron SE, 2 December 2016; available at <https://www.treasury.gov/press-center/press-releases/Pages/jl0679.aspx>.

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