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## GERMANY IMPOSES FOREIGN INVESTMENT REVIEW ON INVESTMENTS BY NON-EU PARTIES

DR. ROLAND HOFFMANN-THEINERT, LAWYER • PARTNER, CHRISTOPHER J. WRIGHT, J.D., LL.M., BARRISTER & SOLICITOR (ONTARIO), GÖRG PARTNERSCHAFT VON RECHTSANWÄLTEN  
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As reported in our August 2008 Newsletter, the German government has been considering legislation that would provide for investment review of acquisitions of German businesses by non-EU parties where the acquisition raises significant “public order or security concerns”. This legislation<sup>1</sup> has now been passed with immediate effect.

A transaction involving the direct or indirect acquisition of at least 25 % of the voting rights in a German business by a non-EU investor may now be reviewed by the German Federal Ministry of Economics and Technology (the “**Ministry**”). Where the Ministry takes the view that the transaction significantly threatens the public order or security of Germany, it may move to prohibit the transaction or to issue directives. Although pre-clearance will now need to be sought for sensitive transactions, it is likely that virtually all acquisitions by non-EU investors will remain largely unaffected.

The foreign investment review programme imposed through this legislation will require parties to an acquisition by a non-EU investor to engage in limited additional pre-transaction planning and analysis. Generally, the review programme is comparable to foreign investment review in other jurisdictions,<sup>2</sup> although several important differences exist. In particular, no thresholds exist with respect to size or sales on the part of the target or the acquiring party. In addition, prior notification of sensitive transactions is not mandatory.

### BACKGROUND TO GERMANY’S FOREIGN INVESTMENT REVIEW LEGISLATION

Germany’s foreign investment review programme has been implemented by way of amendments to the German Foreign Trade and Payments Act (*Außenwirtschaftsgesetz* – the “Act”) and corresponding Act regulations. The Act was passed in 1961 and originally regulated the import and export of sensitive goods, such as currency, gold and military technology. In connection with the liberalisation of the European common market, many of the

Act’s restrictive provisions have been abolished or rendered incompatible with European laws.

Prior to 2009, Ministry review of foreign investments existed only with respect to investments in limited and sensitive sectors, including military weaponry, motors for tracked vehicles, encryption technology used by the state and high-powered satellite surveying technology. Specialised review

procedures still exist for acquisitions in these sectors. They have now been supplemented by a general review provision (section 53 of the Foreign Trade and Payments Regulations) enabling the Ministry to review investments in any sector of the economy, provided certain trigger tests are met, and to block these where public order or security concerns are raised.

In late 2008, the German government discussed numerous forms of draft legislation. The most con-

troversial of these would have included Cabinet-level review of sensitive acquisitions. Transactions resulting in the likely relocation of business activities outside of Germany could have potentially been exposed to essentially political scrutiny. This type of Cabinet-level review procedure was not provided for in the final amendments to the Act. Numerous refinements were also necessary in order to render the amendments to the Act compatible with the framework of European law.

## SCOPE OF APPLICATION – TRANSACTIONS TRIGGERING REVIEW

The Ministry will be authorised to review transactions if the following conditions are met:

- the acquiring party is a non-EU party or at least 25 % of the voting rights in an EU-based acquiring party are held by a non-EU party;
- the transaction involves the acquisition of at least 25 % of the voting rights of a German business (the threshold for exercising veto rights with respect to fundamental corporate changes); and
- the transaction threatens the public order or security of Germany.

Each of these conditions must be unpacked.

**NON-EU PARTY.** In terms of the Act, non-EU parties include individuals, corporations and institutions which do not have a substantial business presence in an EU Member State. Entities which are resident in European Economic Area countries, such as Switzerland or Norway, are considered to be EU parties.

An acquisition of at least 25 % of the voting rights in a German business will also be reviewable by the Ministry where the acquiring party is an EU entity (e.g. a domestic German or French corporation), but at least 25 % of the voting rights in the acquiring party are held by a non-EU party. Indirect acquisitions using an EU-based vehicle are therefore also

reviewable. An unincorporated European branch office of a non-EU party will be disregarded for the purposes of establishing the nature of the acquiring party.

**25 % OF THE VOTING RIGHTS IN A GERMAN BUSINESS.** “German business” (*Unternehmen*) includes corporations, partnerships, joint-ventures and other similar entities, including institutions and business vehicles incorporated under the laws of another jurisdiction, but which have their registered offices in Germany. A transaction resulting in the acquisition of at least 25 % of the voting rights of a German business need not be a purchase; it may also include swap and pledge transactions. An acquisition of an additional 6 % of the voting rights in a German business by a non-EU party which already holds 20 % of the voting rights in the business will trigger the review threshold.

Acquisitions by three separate non-EU parties each of – respectively – 20 % of a German business will not trigger the review threshold, provided these investors are unrelated and are not acting in concert. Where a non-EU party already holds 25 % of the voting rights in a German business and increases its investment, this additional step-up will also not trigger a new review. The incorporation of a German business is exempt. A significant exemption is further presented by the exclusion of asset

deals, even where these involve the sale of all or substantially all of a target business' assets.<sup>3</sup>

**PUBLIC ORDER OR SECURITY.** In its explanatory documents, the Ministry has explicitly drawn upon the European Court of Justice's interpretation of the terms "public order or security". In accordance with this interpretation, it is likely that only critical infrastructure assets and services will be caught, e.g. state-held telecommunications, transportation or other core utility systems necessary for the maintenance of basic services in an emergency situation. The Ministry has specifically stated that the review programme will only apply in "rare, individual cases" where an "immediate and sufficiently serious danger" to fundamental national interests is presented. However, the Ministry has not provided further guidance in respect of these terms and is unlikely to publish a list of examples in the future.

Review is not contingent upon any target or participant size or sales thresholds and in theory, an acquisition in any business sector may meet the tests for review.<sup>4</sup>

## MINISTRY REVIEW PROCEDURE

No formal application for review is required. Instead, the Ministry is entitled to review transactions within three months of the transaction becoming legally effective (e.g. as of the date at which an SPA is signed). In practice, however, the Ministry will be notified by the Federal Cartel Office when this authority receives notification of sensitive acquisitions and by the Federal Financial Supervisory Authority (BaFin) upon the issuance of a takeover offer or the acquisition of 'control' pursuant to the German Takeover Act.<sup>5</sup>

The Ministry must decide within the three-month period whether to review the transaction. If so, it will issue a notice to the parties requiring these to submit extensive documentation to the Ministry.

Upon receiving complete documentation,<sup>6</sup> the Ministry has a two-month period to conduct its review.

The Ministry may choose to either approve the transaction, to prohibit the transaction, or to issue binding directives to the parties. In both of the latter cases, the Ministry will require Cabinet-level approval by the government. This underscores the premise that a prohibition of a transaction is likely to occur only in very rare and isolated instances.

If a transaction is prohibited, the transaction will be rendered retroactively invalid at German civil law. The parties may unwind the transaction, e.g. by relying on contractual provisions contained within the respective transaction documents. In the absence of such provisions, the parties may be able to draw upon German restitution law in order to recover purchase prices paid. In extreme cases, the Ministry is entitled to appoint a trustee to oversee the unwinding and may prohibit the acquiring party from exercising its voting rights.<sup>7</sup>

Fines may be imposed for a failure to submit complete or correct documentation for review purposes or a failure to comply with a prohibition order or other directive. Decisions on the part of the Ministry, including decisions to review a transaction or to impose fines, may be challenged at the German administrative court level.

**PRE-CLEARANCE.** The parties to a proposed acquisition transaction may apply to the Ministry for pre-clearance prior to consummating an acquisition transaction. An application for pre-clearance need include only the identities of the parties involved and a general description of their business activities and the proposed transaction. Upon receiving such an application, the Ministry has a one-month period in which to commence formal review proceedings, absent which the transaction is deemed to be cleared.

## PRACTICAL EFFECTS AND COMMENT

A broad range of transactions are likely to be regarded as outside the scope of the Ministry's review prerogative under the Act. Transactions which could not be regarded as posing a threat to Germany's public order or security would include virtually all real estate transactions involving a corporate vehicle, as well as most acquisitions of businesses in the retail and services sectors. To the extent that a purchaser can determine that a target is not engaged in any potentially sensitive activities, it will likely be safe to assume that Ministry review is remote or that such review will be positive. For example, in the context of due diligence proceedings, the absence of government contracts or permits with respect to the products or services provided may be an indication that Ministry review is unlikely. It is also unclear how the Ministry will obtain knowledge of transactions which do not involve takeover bids pursuant to the Takeover Act or pre-notification with the Federal Cartel Office. Smaller acquisitions may fly under the radar in many cases, unless government consent to the transaction (e.g. contractual consents, permit transfers, etc.) is required.

However, for larger acquisitions by non-EU parties of potentially sensitive German businesses, especially those in the infrastructure, technology, software or dual-use goods sectors, the pre-clearance procedure will be necessary to ensure that the transaction can take place with sufficient legal certainty. In such cases, transaction documentation should contain conditions precedent providing that the transaction becomes effective only upon Ministry pre-clearance or the successful conclusion of review proceedings.

In initial discussions surrounding this proposed legislation, it was suggested that investment review would apply particularly to inbound investment on the part of 'sovereign' (state-owned) entities, particularly those from China and Saudi Arabia. This concern has been dismissed; in its explanatory policy documents, the Ministry has noted that sover-

eign investments rarely exceed the 25 % threshold provided for by the Act. As has been pointed out by several commentators, it is more likely that the Act's amendments reflect a desire on the part of the German government to establish a statutory foundation for becoming involved in major, critical transactions. Whether such involvement will extend to transactions contemplated with respect to prominent German companies seeking foreign investment, such as carmakers Opel or Porsche (both of which are presently engaged in discussions with non-EU investors), remains to be seen.

In general, non-EU investors considering proposed transactions involving German businesses will need to be sensitive to this new potential for Ministry scrutiny. Until the Ministry establishes a track record of pre-clearance and review proceedings, advisors should err on the side of caution.

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<sup>1</sup> *Dreizehnte Gesetz zur Änderung des Außenwirtschaftsgesetzes und der Außenwirtschaftsordnung*, German Federal Gazette 2009 I, p. 770

<sup>2</sup> In particular, the US *Foreign Investment and National Security Act of 2007* (see here *Krause*, BB 2009, 1082) and the Canadian *Investment Canada Act*

<sup>3</sup> As in other jurisdictions, a sale of all of a business' assets would generally result in a transfer of the vendor's employees to the acquiring party

<sup>4</sup> It is far more likely that an acquisition in the sectors of infrastructure, data protection or military technology will be caught, but it is possible to conceive of situations in which 'a sufficiently serious danger' could at least be argued with respect to data management (e.g. software for managing taxpayer or health data), or even service providers which contract with essential federal facilities

<sup>5</sup> § 10 (1) and § 35 (1) of the German Takeover Act (*Wertpapierübernahmegesetz*)

<sup>6</sup> As in other jurisdictions, it will likely be possible for the Ministry to prolong the total review period by requesting additional documentation and information

<sup>7</sup> It is unclear how this would work in practice, especially where jurisdiction is sought over non-EU entities

**DR. ROLAND HOFFMANN-THEINERT,  
LAWYER • PARTNER**



- Practice specialisations: Restructuring, corporate, complex corporate transactions, notary
- Professional Banking Apprenticeship, Dresdner Bank AG
- Study of Law, Political Science and Philosophy in Passau and Freiburg
- Research Fellow, Freiburg University and the Cologne University Institute for Banking Law; Employment with Dresdner South East Asia in Singapore (1986) and ABD Securities in New York (1988)
- Executive aide to the CEO of one of the largest German financial services companies (1991)
- As of 1991, practicing attorney, law firm of Lürer & Görg (predecessor firm of GÖRG Partnerschaft von Rechtsanwälten)
- Founding partner and Head of the Berlin Office (as of 1993) and long-standing member of GÖRG's Management Board

**CHRISTOPHER J. WRIGHT, J.D., LL.M.  
BARRISTER AND SOLICITOR (ONTARIO)**



- Study of law at the University of Toronto Faculty of Law (2001), LL.M., Freie Universität Berlin (2004), Research Fellow, Chair for Business Tax Law, Heinrich-Heine Universität Düsseldorf (2005-6)
- Qualified as a Barrister & Solicitor (Ontario) in 2002
- Corporate and Tax Associate, Baker & McKenzie (Toronto and Frankfurt/M.)
- As of 2007: Associate (Corporate M&A and Tax), GÖRG Partnerschaft von Rechtsanwälten (Berlin Office)
- Regular involvement in cross-border transactional projects

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OUR OFFICES:

BERLIN ■ Klingelhöferstraße 5 ■ 10785 Berlin ■ Tel. +49-30-884 503-0 ■ Fax +49-30-882 715-0

COLOGNE ■ Sachsenring 81 ■ 50677 Cologne ■ Tel. +49-221-33 66 0-0 ■ Fax +49-221-33 66 0-80

ESSEN ■ Ruhrallee 175 ■ 45136 Essen ■ Tel. +49-201-43 77 6-0 ■ Fax +49-201-43 77 6-20

FRANKFURT/M. ■ Neue Mainzer Straße 69-75 ■ 60311 Frankfurt/M. ■ Tel. +49-69-17 00 00-17 ■ Fax +49-69-17 00 00-27

MUNICH ■ Prinzregentenstraße 22 ■ 80538 Munich ■ Tel. +49-89-30 90 667-0 ■ Fax + 49-89-30 90 667-90