Legal Update
German Foreign Investment Review Rules Amended

Infrastructure and Software Acquisitions in Germany by Non-EU Parties are Now Subject to Enhanced Review

Christopher J. Wright, J.D., LL.M., Counsel
Dr. Julian Asmus Nebel, Associated Partner

Berlin, July 2017

The German Federal Government adopted a series of amendments to the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung*) in July 2017; the amendments increase the scope of the Federal Ministry for Economic Affairs to review (and potentially block) acquisitions by a non-EU purchaser of a German business that is active in a sensitive infrastructure sector.

Under the Foreign Trade and Payments Act (*Außenwirtschaftsgesetz*), the Federal Ministry for Economic Affairs may review and block transactions through which a non-EU resident acquires at least 25 % of the voting rights of a German business and the "public order or security" of Germany is potentially threatened by the acquisition. Mandatory notification of transactions is required for transactions in the defence and IT security sectors; in other cases where public order or security may be involved, the purchaser must assess whether notification might be required or prudent. Reviewable - and potentially problematic - transactions generally include those relating to sensitive infrastructure and critical technology. If the transaction is reviewed and deemed to be a threat, the Ministry has the power to (also retroactively) prohibit it. In practice to date, only a very small number of transactions have been reviewed under the "public order or security" provisions, although in 2016, certain prominent transactions involving Chinese purchasers of sensitive technology were reviewed (e.g. AIXTRON SE).

The amendments to the Foreign Trade and Payments Ordinance ("**FTPO**") specify in detail certain business sectors that may potentially be covered by "public order or security". They also enhance the anti-avoidance tests to more comprehensively address the situation where a non-EU indirect purchaser uses an EU-based company as a purchasing vehicle. Finally, notice and review periods have been extended. These longer timeframes will need to be taken into account in planning transactions in the designated sensitive sectors. The amendments are discussed briefly below.

I. Specific sector application

The FTPO now sets out that a threat to public security or order may, in particular, be posed where the domestic German target business is active in one of the following sectors:

- Critical infrastructure operation, which is broadly understood to encompass infrastructure in the areas of energy, IT and telecommunications, health, water and food, as well as other utilities

essential for the functioning of communities. Notably, critical infrastructure may also include financial institutions and insurers (see below)

- Software used in operating critical infrastructure (as set out above)
- Telecommunications monitoring (including sensitive know-how involving the monitoring of telecommunications)
- Large-volume cloud-computing services
- Telematics components and services
- Software in specific branches, such as energy plant management and controlling, utilities management, language and data transmission, payment transaction and resolution systems, securities transaction and insurance services, healthcare information management, transportation and logistics

These sectors are in most cases extremely broad. The 'critical infrastructure' test is unlikely to be met by smaller or niche businesses operating in these sectors, much less a potential threat to "public order or security". Nonetheless, additional care should be taken where a non-EU purchaser seeks to acquire a business in Germany that occupies an exclusive or pivotal niche in any of these areas.

II. Indirect acquisitions targeted

To date, the FTPO rendered acquisition transactions reviewable (and capable of being blocked) where "an abusive approach or a circumvention transaction" was undertaken to avoid Ministry review. Branches and permanent establishments of non-EU businesses were disregarded, but a potential (and obvious) loophole was available where a non-EU business formed an EU-based subsidiary to act as a purchaser vehicle.

This possible loophole has now been closed: The FTPO amendments have added an economic substance test; indications of an abusive approach or a circumvention transaction are now found, in particular, where the direct purchaser pursues no notable independent domestic commercial activity or has no long-term presence in the European Union in the form of business premises, personnel or facilities/equipment.

This test clarifies that a non-EU purchaser generally cannot use a European shell company or SPV to facilitate an acquisition as a nominal EU purchaser and accordingly avoid the application of the FTPO.

III. Review periods extended

Prior to the FTPO amendments, transactions that were reviewable could be investigated (and retroactively blocked, resulting in an obligation to unwind these) within three months of the signing of a purchase agreement (objective test). The amendments to the FTPO increase this period to three months after the Ministry obtains knowledge of an acquisition transaction (subjective, but potentially based on e.g. capital markets filings) for the period of five years after such an acquisition. In the event that an acquisition is pre-notified, the Ministry now has two months to issue a certificate of non-objection (or to decline to respond, amounting to permission). Previously, this period was one month (matching the period

for merger control notification). If a review is initiated, the Ministry now has four months (previously two) to conduct its examination (this period can be extended if the Ministry asserts that remedial measures are required).

These extended periods afford the Ministry more time for deliberation, indicating that heightened review may well be regarded as a priority by the Ministry. The extended periods need to be accounted for in structuring closing conditions in purchase agreements for acquisitions by non-EU parties in the sensitive sectors noted above. The five-year look-back period (with the drastic consequence of retroactive prohibition) will undoubtedly increase the number of precautionary review notices that will be filed for transactions in sensitive sectors.

IV. Comment

Coming on the coattails of a year in which several prominent transaction reviews took place, the new FTPO amendments indicate that the Federal Ministry of Economic Affairs intends to devote additional resources to reviewing acquisitions by non-EU parties in sensitive sectors. The primary focus seems to be technology-driven; acquisitions by non-EU parties of software and other technology with the capability of affecting critical infrastructure will be subject to enhanced examination.

As with merger control notification, it will take time for practitioners to discern patterns of application and to be able to provide a realistic assessment of whether review is likely to be *pro forma* or will potentially lead to a substantive (and time-consuming) investigation. For now, non-EU purchasers of businesses with critical significance to sensitive economic and utilities sectors should exercise precaution and should pre-notify transactions with the request for a certificate of non-objection.

GÖRG has considerable expertise in preparing applications for clearance and in structuring transactions for foreign purchasers in sensitive sectors, including in the energy infrastructure, financial services and telematics sectors.

Note

Our offices

GÖRG Partnerschaft von Rechtsanwälten mbB

BERLIN
Kantstraße 164, 10623 Berlin
Phone +49 30 884503-0, Fax +49 30 882715-0

COLOGNE
Kennedyplatz 2, 50679 Köln
Phone +49 221 33660-0, Fax +49 221 33660-80

ESSEN
Alfredstraße 220, 45131 Essen
Phone +49 201 38444-0, Fax +49 201 38444-20

FRANKFURT AM MAIN
Neue Mainzer Straße 69 – 75, 60311 Frankfurt am Main
Phone +49 69 170000-17, Fax +49 69 170000-27

HAMBURG
Dammtorstraße 12, 20354 Hamburg
Phone +49 40 500360-0, Fax +49 40 500360-99

MUNICH
Prinzregentenstraße 22, 80538 München
Phone +49 89 3090667-0, Fax +49 89 3090667-90