

Amendments to the German Foreign Trade Regime: Strong Impact on Foreign Investments in Germany

I. Background and recent developments within the German/European Foreign Trade Regime

Amendments to the German/European foreign trade regime have become subject to a broader legislative discussion since “headline-takeovers”, in particular involving Asian investors, which raised public attention in 2016. This development reached its climax in October 2016, when the German Federal Ministry for Economic Affairs and Energy (“**German Ministry**”) revoked an already issued clearance permit regarding the EUR 670 million takeover of Aixtron, a German semiconductor equipment supplier, by Chinese investor Fujian Grand Chip Investment Fund (FCG). Prior to this, the competent US authority, the Committee on Foreign Investment in the United States (CFIUS), had issued a recommendation according to which the sale of Aixtron should be cancelled (Please refer to our January 10, 2017 [Legal Update](#) for more details and other discussed acquisitions.) In this context, the German Ministry announced its intention to develop a plan to foster “fair competition” and secure “better protection for foreign takeovers”. With the amendment to the German Trade Regulation the first component of this agenda has now come to light.

II. Mechanism and Amendment to the German Foreign Trade Regulation

The German Ministry may review and prohibit certain acquisitions of domestic companies by foreign investors. German foreign investment review operates a cross-sector approach, applying to all sectors (please see paragraph 1), as well as a sector-specific approach, focusing on defense- and/or encryption-related products (please see paragraph 2). Within each respective approach, the German Ministry has

to decide (i) whether it initiates an in-depth review, and if it does so (ii) whether it prohibits the acquisition.

An amendment to the German Trade Regulation (“**Amendment**”) proposed by the German Ministry has recently been approved by the German government and has already entered into force.

1. Amendments to the Cross-Sector Approach

Pursuant to the cross-sector approach, the German Ministry had to meet substantial requirements to initiate an in-depth review and further more substantial requirements to prohibit an acquisition. These decisions had to be taken within short time periods. In general terms, the Amendment clarifies what are substantial requirements and extends the time periods for decision making.

The Amendment makes the following changes to the cross-sector approach:

The German Ministry may initiate an investigation regarding an acquisition of at least 25% of the shares in a domestic company by a non-EU or non-EFTA company if the acquisition may lead to risks to public order or security. An acquisition by a domestic acquisition vehicle which does not have its own essential domestic business activity and is held by a non-EU or non-EFTA investor would still be regarded as a foreign investment.

In order to define the broad terms “public order or security”, the Amendment gives examples of industries which will be captured by the regulation in any case (“**Catalogue**”). However, while the Catalogue clarifies these terms, it is not conclusive and therefore, it does not limit the German Ministry’s right to initiate investigations on other industries.

According to the Catalogue, a risk to public order or security may arise if the domestic company:

- Is an operator of a “critical infrastructure” which includes the sectors telecommunication, water and energy, information technology and telecommunication, healthcare, transport and traffic, finance and insurance, as well as nutrition;
- Develops or amends software to operate such critical infrastructure;
- Manufactures, has manufactured or is aware of telecommunication technology to implement governmental telecommunication surveillance measures;
- Delivers certain Cloud-Computing-Services, e.g. server farms; or
- Holds a permit to deliver telemetrics infrastructure for the health industry.

If the German Ministry is of the opinion that the acquisition may put at risk “public order or security”, in particular because the domestic company belongs to an industry mentioned in the Catalogue, the Amendment provides that the German Ministry may initiate an in-depth review within three months after – and this was newly incorporated by the Amendment – it has become aware of the conclusion of the

SPA. Accordingly, a new duty to notify the conclusion of SPAs regarding businesses in the Catalogue’s industries has been introduced. The right of the German Ministry to initiate such a review process is limited to five years after the conclusion of the SPA. At present, this cut-off period applies to all acquisitions that will not have been notified to the German Ministry. The Amendment, unlike merger control regulations, does not include a prohibition on the completion of an acquisition. The acquisition can be completed taking into account the risk that it may be reversed.

If an in-depth review process is kicked-off, the purchaser must file all documentation in connection with the SPA (presumably in German). The Amendment prolongs the review process from two to four months. The Amendment now expressly allows the German Ministry to negotiate with the parties certain clauses to ensure the deal does not contradict reasons of public order or security. During such negotiations the review period is suspended. As in the past, the review period only starts when the German Ministry has confirmed that the notification is complete which may further prolong the proceeding.

As before the Amendment came into force, the German Ministry may grant a clearance permit. The purchaser has the right to apply for a clearance permit stipulating that the deal does not affect public order or security. The Amendment however prolongs the review process for up to two months.

Aspect	Former	New
Investor origin	Non-EU or non-EFTA company	No change, however, clarifications for an indirect acquisition through a domestic acquisition vehicle
Size of investment	At least 25% of the shares in a domestic company	No change
Prohibition reasons	Risk of public order or security; no further details	In addition: clarifying/expanding list with affected industries: “IT-” and/or “key industries”
Notification obligations	None	Notification requirement re SPA relating to “IT-” and/or “key industries” (Catalogue industries)
Deadline for initiating the review process	Three months after conclusion of the SPA	Three months after becoming aware of the conclusion of the SPA
Period for conducting the in-depth review process	Two months	Four months
Suspension of the deadline	No	Yes, during negotiation between the German Ministry and SPA parties
Review period for a clearance permit	One month	Two months

2. Amendments to the Sector-Specific Approach

The Amendment implements similar measures in relation to the sector-specific approach. Prior to the Amendment, the sector-specific approach had been even more rigid than the cross-sector approach. Now, the list of defense- and/or encryption-related products as well as review periods have been adjusted and extended.

III. Evaluation of the Amendment and Deal Preparation

Although the German Ministry estimates that the Amendment will lead to a moderate increase of ten review proceedings per annum bringing the total amount of cases handled at the German Ministry to about 60, we think that there will be significantly more work for the relevant department of the German Ministry in the future. The Catalogue, although meant as a clarification, in fact significantly expanded the list of relevant industries or businesses. Further, the notification requirement may bring numerous additional M&A matters to the attention of the German Ministry which may trigger additional proceedings. The potential of more and longer in-depth reviews will increase the workload of the German Ministry, also leading to longer waiting periods for affected parties.

The prolongation of the review periods will also lead to less deal certainty during the review process. This may place additional cooperation obligations on the purchaser and the seller. Parties will have to decide if the seller or the purchaser shall bear the risk of non-clearance, similar to hell or high water clauses in the merger control area. In light of the notification obligation regarding an acquisition in the Catalogue industries, the parties must carefully assess the target's industry sector in order to decide if the relevant business is part of the Catalogue or not. Given that the Catalogue only lists examples, parties are likely to choose to notify in order to be on the safe side.

IV. Outlook

The Amendment is part of various attempts to amend the German and European foreign trade regime. The German government has emphasized that it still continues to promote a pan-European approach. In February 2017, Germany, together with Italy and France, addressed in a letter to the European Commission their concerns about the lack of reciprocity and about a possible sell-out of European expertise. In this letter, the parties proposed key points for investment reviews at the European level reflecting

measures of reciprocity and vetoes against sell-outs (“**Proposal**”). The Commission and other European member states are still reviewing the Proposal and the Commission has already announced that it will critically assess whether foreign investments are facilitated by governmental subsidies granted to foreign investors.

The German/European foreign trade regime remains in a state of flux, in particular in light of the Amendment and the Proposal. The Amendment may be subject to court decisions which will provide greater clarity to foreign investors and their acquisitions in Germany, however this will take some time. The current political objectives of the German Ministry in the area of foreign investment control are reciprocity and a “better protection of German key industries”. At least the intervention rights have now been expanded. Professional deal preparation and coordination as well as sound legal advice have become even more crucial as notification obligations and further bureaucratic coordination will increase with the Amendment.

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