Under Review: German Ministry activates the Foreign Investment Regime

I. Legal background of the German/European foreign trade law regime

Foreign Direct Investment ("**FDI**") screening procedures have become of particular interest in M&A scenarios worldwide. A new legislation reforming CFIUS and US review of FDI was signed by US President Trump on August 13, 2018. (Legal Update August 2, 2018 Timothy Keeler et al.) One of the key amendments deals with the expansion of CFIUS's rights to review any investment by foreign persons in US businesses of certain crucial infrastructure. A similar development is under way in European and German legislative reforms. In September 2017, the European Commission – backed by a joint statement of Germany, France and Italy – proposed a framework for an FDI screening mechanism permitting the European Commission to review certain investments that are relevant to EU interests. The proposal is still under review and has faced opposition in some member states. However, such proposal is in line with legislative and executive developments in Germany. In October 2016, the German Federal Ministry for Economic Affairs and Energy ("**German Ministry**") revoked, in close cooperation with the US authorities, for the first time ever, an already issued clearance certificate regarding a EUR 670 million takeover of a German semiconductor equipment supplier by a Chinese investor. (Legal Update January 10, 2017 Klaus Riehmer et al.) Following an intense political debate, the German Ministry announced its intention to foster "fair competition" between non-European and European investors and to secure national interests which could possibly require to act on the principle of reciprocity regarding FDI.

In July 2017, the German government eventually passed an amendment to the German Foreign Trade Law Ordinance naming "critical infrastructures" which should be protected against foreign takeovers as well as stipulating longer "regular" and in-depth review periods by the German Ministry. (Legal Update July 25, 2017 Klaus Riehmer et al.)

Initiated by the new German government (again formed by conservatives and social democrats), the public spotlight frequently focuses on mid-cap and larger transactions involving FDI by Asian investors. This development has led to the recent climax when the German government was about to issue a prohibition for a certain foreign investment for the first time ever (see below "The Leifeld case"). Further, the German government considers once again expanding the German Ministry's right to review certain FDI transactions as well as encourages the German Ministry to make use of its existing rights by reviewing FDI investments critically (see below "Executive and legislative developments").

II. Under review: The Leifeld case

In 2017/2018, the Chinese investor Yantai Taihai Corporation ("**Yantai Taihai**") intended to acquire through its French subsidiary Manoir Industries a significant stake in the Germany-based "Mittelstand" machine tool manufacturer Leifeld Metal Spinning AG ("**Leifeld**"). Leifeld's sales amount to approximately EUR 40 million per annum. In spite of the moderate revenues, it is regarded as a leading company in the field of high-strength materials for the aerospace sector and the nuclear industry.

The Chinese-controlled French subsidiary applied to the German Ministry for a clearance certificate regarding the planned takeover. Under the German foreign trade law it makes no difference whether a foreign investor directly or indirectly (e.g. via an investment vehicle or subsidiary) acquires shares in a German company. As time passed, it became obvious that the government intended to veto the deal because of concerns related to the German "public order and security" as well as a general fear of a drain of cutting-edge technology. Manoir Industries eventually withdrew its application and terminated the purchase process in August 2018. Therefore, a final and official decision by the German government was not necessary.

III. Executive and legislative developments in Germany

The Leifeld case illustrates the recent executive developments at the German Ministry. The German Ministry is willing to activate the mechanisms under the tightened German foreign trade laws. The amendments to the German Foreign Trade Ordinance in July 2017 allowed a stakeholder to identify certain "critical infrastructure" by rather formal criteria. Now, the German Ministry has demonstrated its determination to protect these industries. However, it has to be noted that under the so-called cross-sector approach the German Ministry is entitled to review any transaction if the investor's origin is non-EU or non-EFTA and the size of the investment is at least 25% of the voting rights in a domestic company. Furthermore, the German Ministry makes use of the prolonged review periods. Whereas the German Ministry's "regular" review right is limited to two months after the deal notification with the German Ministry, it has the right to conduct an in-depth review for additional four months which creates a wide range of uncertainty in M&A processes.

The amendments in July 2017 introduced a negotiation procedure between the German Ministry and the SPA-parties. In this context, the SPA-parties increasingly consider reaching out to the German Ministry "informally" to evaluate the level of concerns at the German Ministry in relation to the transaction. This might help to frame timing and workload.

Further, it became apparent in another recent case how the authorities use "soft influence" to impede possible transactions. Besides creating public attention and resistance, the German government might engage other stakeholders to intervene. The Chinese state-owned State Grid Corporation of China attempted to acquire 20% of the shares in 50Hertz Transmission GmbH, a German power grid operator. Although the investment was below the threshold of 25% which would trigger the German Ministry's right to review the deal, the German governmental representatives made use of their influence on KfW, a state-owned German bank, to acquire the stake for sale.

At the beginning of August 2018, the German government announced its plan to strengthen the FDI legal framework again. Giving the impression that the latest amendments to the German Foreign Trade Ordinance and the European Commission's proposal are not sufficient, the German government considers lowering the threshold for a review process from 25 to 15%. A proposal backed by a German federal state attempts to lower the threshold to even 10%.

IV. Outlook and deal preparation

The foreign trade law remains in a state of flux. From a German perspective, it has to be noted that there is a more substantial shift in the (public) mindset than an actual legislative revolution that increases the level of scrutiny. To ensure a rather smooth and frictionless process, the SPA-parties should take the following indications into consideration:

1. The origin of the potential purchaser and the industry of the potential target have to be assessed carefully. The more the investor is influenced or controlled by a foreign state, the more concerns will likely be raised to avoid a "sell-out" of Germany's key industries, in particular to non-private entities. Regarding the target industry, the German Foreign Trade Law Ordinance allows the indentification of "critical infrastructure" which is of particular interest for the German public order or security.

2. Taking the above-mentioned aspects into consideration, the timing for closing a deal must be reviewed in this regard. But even if the transaction is not in the German Ministry's focus, the clearance process might be lagging due to prolonged scrutiny periods and a higher workload at the German Ministry.

3. Depending on the specific deal scenario, it should be considered whether and to what extent an "informal" approach to the German Ministry is advisable. Furthermore, particularly in the energy sector, it should be assessed how other shareholders in the target company might act in light of the anticipated FDI, in particular whether they are influenced or controlled by a governmental authority which could lead to an execution of special shareholder's rights in the interest of the authority (pre-emptive rights, etc.).

4. Last but not least, it has become even more crucial in an international environment of aligning concerns in Western countries in connection with FDI to establish a "one voice" policy towards national authorities. As seen in many cases and emphasized by the European proposal for a framework for an FDI screening mechanism, the cooperation between the authorities is increasing. Therefore, a coordinated approach for (getting to) clearance is required on both sides, the applicants and the authorities.

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