Germany tightens its rules on foreign corporation acquisitions and proposes an EU regulation

Focus on corporations dealing with critical infrastructures and extension of inspection periods

Germany proceeds with stricter rules on foreign corporation acquisitions after Chinese investors increased their interest in buying companies with important technology and know-how in 2016.

The investment environment

China is the second biggest trade partner of the European Union (EU) behind the United States. Vice versa the EU is China’s biggest trade partner. According to Mercator Institute for China Studies, the People’s Republic’s foreign direct investment increased up to 11 billion euros for completed deals in 2016 (regarding China’s foreign investments, see the article by Dr. Christian von Wistinghausen). Germany was the largest recipient, accounting for 31 % of the total Chinese investment in the EU.1 However, over the last few months, the lack of reciprocity has been criticised by the European Member States and the European Chamber of Commerce in Beijing.2 Major hurdles for foreign investors in China represent inter alia a lack of transparency, complex ownership structures and a strengthening of State-owned enterprises rather than the opening of the market promised at the time of China’s accession to the WTO. The acquisition of German robotics manufacturer Kuka by the Chinese company Midea raised concerns about losing key technologies to non-European investors.

German legal conditions for investment

The German legal framework for acquisitions of companies is “light” and investments by foreigners are subject to review only in exceptional cases. A sector-specific investment review and a general investment review. The first one concerns the defence industry or IT security for classified information. The second is of general nature and allows reviewing the acquisition if the investor is not a resident of a European Union or European Free Trade Association member state. The acquisition may only be prohibited if it endangers German public order or security.

We recommend that investors voluntarily notify the competent authorities when acquiring targets whose activities might even remotely could give raise to public order or security concerns, in order to avoid uncertainty.

The German legal order also looks at the competition for the products concerned by the acquisition, according to the Act against restraints of competition (GWB). Such a review depends on the size of the acquisition and is a review purely according to legal criteria and market-economy based, not political. Of note are also sector-specific requirements, such as in the banking sector, but these also do not allow for political considerations to be taken into account. For instance, BaFin, Germany’s Federal Financial Supervisory Authority, welcomed Chinese investment in the German banking sector as recently as May 2017.3

The revised framework

The German Ministry for Economic Affairs and Energy adopted a regulation amending the national ‘German Foreign Trade Ordinance’. This kind of regulation is adopted solely by the executive and is based on an Act of Parliament. The
The regulation stipulates according to past and present legislation that an acquisition of an at least 25% investment share in national corporations by non-European or – in case of misuse – European corporations can be reviewed by the Ministry.

The purchaser now must register every acquisition of the industries mentioned in the regulation with the Ministry. Furthermore, the Regulation foresees an extension of review periods. The Ministry will have more time than before for reviews, which means four months upon notification in case of cross-sector inquiries and three months for sector inquiries until the appropriate measures have to be taken. The two different procedures sector-specific investment review on the one hand and cross-sector investment review on the other hand aim to safeguard public security. The difference is that the sector-specific inquiry contains stricter controls concerning more security-sensitive areas (see the article by Georg Philipp Cotta and Christoph Heinrich).

Cross-sector inquiries

The new Regulation defines more precisely the situations of endangerment of public order and security envisaged by the legislator. In this case the Ministry can intervene, start a review and, where appropriate, block takeovers. The enterprises that might raise German public order or security concerns are dealing with critical infrastructure, especially software in the fields of telecommunication, cloud-computing, energy and water, finance and insurance, healthcare, transport and food industry. The Ministry has to start its reviews three months after having received notice of the investment. As the final deadline for opening an inquiry is currently set at five years after conclusion of the acquisition agreement, a so-called certificate of non-objection should be proposed by the acquirer to obtain legal certainty before the expiry.

Sector-inquiries

In case of the sector inquiry the target group has been extended to a wider range of defence and IT companies. Companies producing or developing goods that are on the export control list have been added. Furthermore the Ministry is still able to block these takeovers without the Government’s approval.

Initiative for an EU regulation

In addition to the national regulation, the German Federal Government has proposed, together with France and Italy, a regulation permitting the review of investments at EU level. Members of the European People’s Party Group of the European Parliament also proposed a Union act in March 2017 for a Screening of Foreign Investment in Strategic Sectors.

Nevertheless it is unlikely that the EU will adopt legislation on the screening of foreign investment in strategic sectors in the near future. Though the German Chancellor Merkel and the French President Macron are promoting the idea of an European Union screening, other EU countries, such as the Scandinavian, Benelux and Baltic States as well as Poland, Portugal, Greece, Ireland and Spain, were less keen on such a plan.

The European Council discussed the issue at its summit on 23 June 2017 and came to the rather vague conclusion „to analyse investments from third countries in strategic sectors, while fully respecting Members States’ competences. The European Council will revert to this issue at one of its future meetings.”

It should be noted that at the European Union level, mergers and acquisitions will be reviewed for their impact on competition. However, as in Germany, the merger control does not permit prohibiting acquisitions on political grounds. Thus the question of screening investments will be kept separate from merger control.

Finally, one should note the context of the negotiations of an investment agreement between China and the EU. The Commission’s Vice-President Jyrki Katainen emphasizes that full investment reciprocity with China should be a priority. Altogether it is more likely that the EU focuses on a Comprehensive Agreement on Investment. Its aim is to rebalance the economic relationship, persuade China to reduce the number of protected sectors and to reduce national security reviews. This may lead to multiplying and diversifying economic opportunities and sources of growth in Asia.

Conclusions

The modifications to Germany’s investment review laws are part of the wider trend
to scrutinize investments and be vigilant about allegedly dangerous foreign takeovers. One can expect an increase in the numbers of investment reviews but probably not a significant change in the general climate for investments in the EU or Germany.

As a matter of precaution, investors must pay more attention to the modified control situation in Germany and we recommend a notification where the target’s activities might even remotely give raise to public order or security concerns. To be prepared, take expert advice.

If you have any questions regarding this topic, please feel free to contact Dr Rainer Bierwagen.

[1] 9th Regulation amending the Regulation „German Foreign Trade Ordinance“. And the German text of the Aussenwirtschaftsverordnung.
[5] See the modifications to Section 55 of the AWV.
[6] See the modifications to Section 60 of the AWV.
[9] Cover Note, General Secretariat of the Council, European Council meeting (22 and 23 June 2017); EUCO 8/17.