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From an American Perspective: M&A in Germany – Even an Acquisition of Only 10% of Voting Rights May Subject a Foreign Investment to Regulatory Review

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Just like the United States with its Committee on Foreign Investment in the United States (CFIUS), Germany has long subjected investments from non-EU and non-EFTA investors -- including those from the United States -- to governmental review. Germany codified the respective provisions in its Foreign Trade Ordinance. The problem with these provisions is that not only did they lack specificity, but the enforcement of these provisions also left ample room for improvement. Germany amended its Foreign Trade Ordinance quite significantly on July 18, 2017 (2017 Amendment) and most recently again on December 29, 2018 (2018 Amendment). Each of these amendments can have an impact on M&A transactions in Germany, including from US investors.

2017 Amendment and 2018 Amendment

The 2017 Amendment authorizes Germany's Federal Ministry for Economic Affairs and Energy to review -- and potentially to block -- foreign direct investment into Germany if its falls into one of two categories:

(1) Sector-specific transactions covered by Sections 60 and 60a of the Foreign Trade Ordinance. Section 60 covers primarily weapons and dual-use goods that may be used for conflict situations. These provisions were left intact for the most part except that the Germany Federal Ministry for Economic Affairs and Energy may review such investments if, even though the investor is domestic, there are indications that the actual ultimate investor is circumventing Germany's Foreign Trade Ordinance by disguising its actual foreign identity. Section 60a, which was introduced in the 2018 Amendment, generally sets forth that foreign investors must hold at least ten percent of the German target's voting rights, either directly or indirectly, for Section 60 to apply; or

(2) Cross-sector specific transactions covered by Section 55 of the Foreign Trade Ordinance; this covers transactions that may impact Germany's "public order" or "national security", in particular, if the target entity is engaged with:

a. "Critical infrastructure";
b. Sector-specific software, including software used (i) in the energy sector (ii) in the water supply industry, whether for drinking or for sewage systems (iii) in the IT or telecommunications industries (iv) in the financing or insurance industry (v) in the health industry (vi) in the transportation industry, or (vii) in the food industry;
c. Cloud computing services;
d. Equipment used in the telecommunication industry, in particular to monitor telecommunications; and
e. Technology used in the telematics industry.

The 2018 Amendment added one more category to this list, that being the news and media industry as it concerns broadcasting, telemedia and print media. As the media's influence throughout the world changes -- some good and some not so good -- the German government took the increased risks of propaganda and disinformation into consideration. The German government wants to keep its eye not only on the Rupert Murdochs of the world, as well as the Rupert Murdoch wannabees but, to be frank, even more so on Chinese investors who wish to invest in Germany.

Some commentators have expressed surprise, and even concern, as to how politicized foreign direct investment has become. This should not be a surprise, in particular, when one considers the increased influence of state-owned enterprises and of large conglomerates. As said recently by Thorsten Benner, the Director of a Berlin-based think tank: "There used to be a belief that Germany and China were perfectly complementary partners. Now we have realized that China has become a core competitor and that it uses investment in a very strategic manner to copy technology and accelerate the catch-up. And there is a realization that Chinese investment has an impact on national security."

Chinese Investments Are Impetus for Amendments

In 2015, China made 40 acquisitions in Germany. This figure skyrocketed to nearly 70 in 2016. The number of Chinese investments in Germany declined to approximately 55 in 2017, but this was still the second biggest year for Chinese acquisitions in Germany. The number of acquisitions continued to decline in 2018, presumably in large part because of Germany's more rigid stance on Chinese investment. Two of the most notable transactions occurred in 2016: China's acquisition of the German robot maker Kuka for EUR 4.4 billion and Beijing Enterprises' acquisition of EEW Energy, a German waste incineration and power generation company. It is precisely these types of transactions that caused Germany to reconsider its statutory provisions on foreign direct investment. For a myriad of reasons, Germany could not focus only on investment from China, so it "focused" on any investment from outside the European Union or EFTA, including that from the United States.

Threshold for Review Reduced from 25% of Voting Rights to 10% of Voting Rights

Under the 2017 Amendment, a transaction for the purchase of an entity was subject to review only if a non-EU or non-EFTA buyer (such as a US buyer) acquired at least 25% of a German company's voting rights. This threshold was reduced in the 2018 Amendment to 10% of voting rights if a transaction involves the industries set forth in (1) or (2) above, plus the news and media industry. The threshold remains at 25% for other investments that may impact Germany's public policy or national security. The value of the transaction does not play a factor, meaning even transactions with a low purchase price may be subject to review.

Why was it reduced to 10%? All indications are that this goes back to a transaction from early 2018 in which State Grid Corporation of China (the second largest company worldwide after Walmart) sought to acquire a 20% interest in 50Hertz. 50Hertz owns and operates a significant power line network in eastern Germany and around Hamburg, Germany. Because the intended acquisition was below the then-current 25% threshold, it was not subject to governmental review. Nevertheless, it caused concern among German politicians as well as the German media and consumers. Also, Li Shufu, a Chinese national and chairman of the Chinese automotive group Geely, acquired a 9.69% interest in Daimler, becoming its largest shareholder. This transaction garnered great attention throughout Germany even though it fell under the 10% threshold. Regardless, it quickly became clear that a 25% threshold was not sufficient to "protect" Germany's interests.

European Union Adopts Foreign Direct Investment Regulation

Germany is not alone in terms of paying increased attention to foreign direct investment. Just in 2018 the United States enacted the Foreign Investment Risk Review Modernization Act (FIRRMA), which expands CFIUS' jurisdiction to review transactions, including non-controlling investments, that were not previously subject to review. The European Union, too, has introduced changes in terms of foreign direct investment. On March 5, 2019, the European Union introduced a mechanism for member states and the Commission to exchange information and to be able to raise concerns about specific investments taking place within the European Union. The Commission may also issue opinions when an investment impacts the security or policy order of more than one member state.

It is important to note that the new EU framework does not require each EU member state to introduce a screening mechanism for foreign direct investment (right now 14 of the 28 EU member states have such mechanisms in place) so the changes are much less invasive than individual member state's review processes. Nevertheless, the provisions do call for increased cooperation among the member states. Whether this will motivate additional member states to introduce national screening mechanisms remains to be seen, but some EU jurisdictions, most notably the Czech Republic, Denmark, the Netherlands, and the United Kingdom have indicated that they may introduce or significantly amend their review process, in whatever form, in their respective jurisdictions in the near future.

Germany Remains a Viable Site for Foreign Direct Investment

Germany and the European Union are placing increased attention on foreign direct investment. Despite this increased attention, as evidenced by foreign direct investment figures of late, Germany and the European Union are, and will continue to be, attractive investment sites. It is just that, like many other jurisdictions of the world (including the United States and China), Germany and the European Union wish to keep a close eye on who is investing and the potential impact of such investments.

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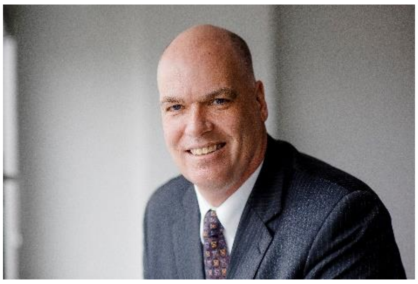

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