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## Potential restrictions on foreign investment in German companies: The reform of foreign trade legislation in Germany

A bill to reform German foreign trade legislation (Entwurf eines Dreizehnten Gesetzes zur Änderung des Außenwirtschaftsgesetzes und der Außenwirtschaftsverordnung; BR-Drucks. 638/08) introduced by the Federal Government on August 29, 2008, is currently before the German Parliament and is expected to be discussed shortly. The bill proposes modifications to the Law on Foreign Trade and Payments (AWG) and the German Foreign Trade Regulation (AWV) which will enable the German Federal Ministry of Economics and Technology (the “Ministry”) to examine and potentially prohibit certain foreign investments in German companies. As a compensating measure, foreign investors would be able to apply for a written approval of an investment from the Ministry before undertaking the transaction.

### I Examination of investments by foreign investors under German foreign trade legislation under current law

Under current law, German ministries may only examine investments made by foreign investors in certain defined and highly specialized sectors and enterprises. Those include:

- Investments in German enterprises which develop and produce certain military arms and armaments or encryption technology (sec. 52 AWV; sec. 7 para. 1 nr. 1, para. 2 nr. 5; sec. 28, para. 2 nr. 2; sec. 31, para. 2 AWG)
- The acquisition of stock in a German enterprise which operates a high-quality terrestrial

reconnaissance system (sec. 10, para. 1; sec. 24, para. 3; sec. 25, para. 1 Satellite Data Protection Law (SatDSiG)).

These laws already provide the respective ministries with the possibility to prohibit foreign investments in companies specializing in those sectors. However, until now, no investment has ever been formally prohibited under this legislation. These existing laws will continue to apply even if the new review process for examination of foreign investment (*see* II. below) pending before Parliament is enacted.

## II The new review process for foreign investments in German companies

The proposal of a review process for foreign investment has arisen against the background of a controversial discussion in the German media concerning the investments of non-German sovereign wealth funds in German companies. The ability of the German State to examine investments of non-German investors in German companies has been widely considered to be underdeveloped in comparison to the measures available to other industrial nations, such as the United States, Great Britain or Japan. To address this deficiency, a review process has been proposed in which future investments in German companies by foreign investors (meaning investors who are neither based in a member state of the European Community nor in a member state of the European Free Trade Association) may be examined and potentially prohibited. The examination may take place only if the investment threatens the public order and safety of the Federal Republic of Germany.

### 1. Scope of investors affected?

The proposed amendments would establish a new review procedure affecting all investors who are neither based in a member state of the European Community nor in a member state of the European Free Trade Association (the "EFTA States"), namely Iceland, Liechtenstein, Norway and Switzerland (see the proposed sec. 7, para. 2 nr. 6 AWG defining "foreign investor"). Branch offices and other operating establishments of an investor within the European Community or the EFTA States do not necessarily "base" an investor there for the purposes of the proposed procedure. A company otherwise based in the European Community or an EFTA-state nevertheless will be treated as a foreign investor if a foreign investor holds 25% or more of the voting rights in such company (see proposed sec. 53, para. 1 AWV). This rule to prohibit evasion of the law also applies to companies based in Germany (see [proposed] sec. 4, para. 1 nr. 6 AWG).

### 2. Scope of investments affected?

The proposed review procedure will apply to all transactions in which a foreign investor (see 1. above) directly or indirectly acquires at least 25% of the voting rights in a German company. [Thus, a transaction in which as little as 6.25% of a German company is acquired by a foreign investor can fall within the scope of the proposed review procedure, as in the case of a European Community company in which a foreign investor holds 25% acquiring 25% of a German company.] An indirect acquisition will also be assumed if a foreign investor acquires a [25%] interest in a company based in the European Community or an EFTA-state which already holds a [25%] interest in a German company (see proposed sec. 7, para. 2 nr. 6 AWG). The voting rights of all companies in which a foreign investor holds a 25% or larger stake are added together to determine the total acquisition of voting rights in a German company by the foreign investor (see proposed sec. 53, para. 1, sentence 3 AWV). Also, the voting rights of third parties with whom the foreign investor has agreed to coordinate its voting are to be added to the voting rights of the foreign investor when calculating the 25% stake in the German company.

Any investment in a German company which reaches the threshold of 25% of that company's voting rights will be subject to examination by the Ministry under the pending bill (see proposed sec. 53, para. 1, sentences 1 and 2 AWV and sec. 52, para. 1, sentence 2 AWV). There is no minimum value threshold for the investment to be subject to potential examination. There is also no limitation of the potential examination to investments in certain economic or industrial sectors.

### 3. The review procedure

The pending bill would not establish an obligation of the foreign investor to notify the Ministry in case of an investment in a German company which might be subject to examination. Instead, the Ministry will determine whether to commence an examination based on the information it receives from the press, the market or other governmental bodies (see proposed sec. 28, para. 2 nr. 3 AWG). Irrespective of the

commencement of an examination by the Ministry, the transaction underlying the investment is legally effective subject to a conditional subsequent of prohibition by the Ministry (see proposed sec. 31, para. 3 AWG). The Ministry must commence the review procedure set forth in proposed sec. 53 AWW within three months after the execution of the contractual agreement, the publication of a decision to make a public offering or the publication upon achieving of control regarding the German company. In the review procedure, the Ministry works together with the Federal Financial Supervisory Authority (BaFin) and the Federal Cartel Office (Bundeskartellamt). The Ministry will give formal administrative notice (Verwaltungsakt) to the foreign investor of the commencement of the review. In case the Ministry commences a review, the foreign investor is obligated to transmit all documents concerning the investment to the Ministry. The categories of documents required will be published by the Ministry in a notice in the German Federal Gazette (Bundesanzeiger) (see [proposed] sec. 53, para. 2, sentence 2 AWW).

The Ministry shall decide within two months following receipt of the complete documentation regarding a prohibition of the investment or the issuance of directions (Anordnungen) concerning the investment. Prohibitions of investments as well as directions require the approval of the Federal Government to be valid (see proposed sec. 28, para. 2 nr. 3 AWG). Directions concerning the investment are the milder remedy. A prohibition of the investment shall only come into consideration if the threat to the public order and safety of the Federal Republic of Germany cannot be dispelled by other measures.

The Ministry shall examine whether the investment threatens the public order and safety as defined in art. 46 and art. 58, para. 1 of the Treaty of the European Community of the Federal Republic of Germany (see proposed sec. 7, para. 1 nr. 4, para. 2 nr. 6 AWG). The examination of public order and safety shall primarily concern the merger control considerations in the acquisitions of large companies. Under the jurisprudence of the European Court of Justice concerning fundamental European freedoms, a prohibition of an investment or the issuance of

directions concerning an investment would require an actual and sufficiently grave endangerment of a basic concern of society. Endangerment of the public safety would require a similar effect on the functioning of the government and its bodies. The European Court of Justice has recognized in the past such endangerment of the public safety based on questions concerning the provision and maintenance of telecommunication services, electricity and strategic services in crisis situations. Restrictions on the freedom of mobility and residence, or on the freedom of capital movement and payment, based on concerns for the public order and safety are subject to the rule of proportionality. The foreign investor may take legal action against the commencement of a review as well as against the prohibition of an investment or against directions concerning the investment.

The Ministry is authorized to take measures necessary to enforce the prohibition of an investment. For instance, it may prohibit, restrict or transfer to a trustee of its choice the exercise of voting rights held or controlled by a foreign investor in the acquired company, or appoint a trustee who will unwind the transaction (see proposed sec. 53, para. 4 AWW). If an acquisition has already been completed before the Ministry prohibits the investment, the restitution provisions of the German Civil Code apply (see sec. 812, para. 1, sentence 2, 1st alternative German Civil Code). If the parties undertake such restitution themselves within a short period of time following the prohibition, the Ministry will not need to order such measures. A failure by a foreign investor to provide full documentation concerning the investment when it is requested by the Ministry or to comply with a direction or prohibition of the Ministry shall constitute an administrative misdemeanor (see sec. 33, para. 1 AWG and proposed sec. 70 nr. 11 und nr. 11a AWW).

The Federal Government estimates that approximately ten investments will be examined by the Ministry each year. The new review procedure is not intended to provide a legal foundation for the routine examination of foreign investments in German companies, but rather only to take place in rare cases.

#### 4. Application for a written approval

A foreign investor may apply to the Ministry to obtain a written approval of the investment prior to undertaking a transaction which might fall under the scope of the review procedure (see proposed sec. 53, para. 3 AWV). The application may be filed also prior to the start of the limitations period (see proposed sec. 53, para. 1 sentence 1 AWV).

This presents a foreign investor with a less bureaucratic option to obtain legal certainty concerning an investment in a German company. An application for an approval does not, however, prevent the Ministry from opening an examination.

This information is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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