

GERMAN GOVERNMENT AUTHORISES FOR THE FIRST TIME A PROHIBITION ON FOREIGN INVESTMENT IN GERMANY

In the Leifeld case, the German government issued its first ever authorisation to prohibit a foreign acquisition of a German target. It remains to be seen whether this will be the culmination of a paradigm shift towards tighter control of foreign investments.

GOVERNMENT'S DECISION

Earlier this month, the German government authorised the German Federal Ministry for Economic Affairs and Energy (Bundeswirtschaftsministerium, "BMWi") to prohibit the acquisition of Leifeld Metal Spinning by Yantai Taihai Corporation, a Chinese undertaking. This development could constitute a milestone in the ongoing policy shift towards tighter scrutiny of acquisition efforts on the part of non-European buyers. Whilst stricter controls of foreign direct investments (FDIs) had been in place for some time now, they have not resulted in any outright prohibitions yet. Previous cases – such as *Osram/Ledvance* and *Cotesa* – have entailed long discussions and were subject to commitments but have eventually been cleared. The *Leifeld* decision of the German government now seems to be the culmination of a development that has gained momentum following the revocation of a certificate of non-objection in the *Aixtron* case and measures taken by the German government in other cases, such as intervening in the attempted acquisition of a minority stake in *50Hertz*, in order to put tighter control on Chinese investments.

BACKGROUND ON THE DECISION

Yantai Taihai is a private undertaking based in China that sought to acquire Leifeld Metal Spinning, based in the rural region of Westphalia in north-western Germany and one of the leading manufacturers of mechanical engineering products used for both automotive and aviation but which may also be deployed in the nuclear industry. Following Yantai Taihai's request for a certificate of non-objection, the BMWi launched a cross-sectoral investigation, which later turned into an in-depth examination of the transaction. This was apparently due to concerns of the BMWi in relation to a transfer of sensitive know-how and technology being used for military purposes in China. Despite the acquirer's withdrawal of the request for a certificate of non-objection, the German government nevertheless authorised the BMWi to issue a formal prohibition.

Key issues

- Overall policy shift towards greater scrutiny culminates in first prohibition authorisation
- Threshold for review potentially to be lowered from 25% down to 15%
- Review process is increasingly politicised
- Longer review periods and greater notification requirements affect timing and costs of transaction
- Contractual provisions need to account for risk of remedies and prohibition decision

The authorisation decision of the German government is based on the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung*, "AWV"), according to which any acquisition of German companies by acquirers from outside the EU could be prohibited if the acquisition jeopardise the "public order or security" of the Federal Republic of Germany. This is deemed to be particularly the case if the German target were the operator of a so-called critical infrastructure.

EVEN TIGHTER SCRUTINY AHEAD

The *Leifeld* case may, thus, be interpreted as an indication of stricter enforcement and tighter controls of any foreign investments in Germany. In fact, Germany's Federal Minister of Economic Affairs and Energy Mr Peter Altmaier is reported to consider lowering the current threshold for review even further from now 25% down to a mere 15% in order to review acquisitions in sensitive business areas, in particular with regard to defence-related businesses, critical infrastructures, and civil security-related technologies. This would primarily result in an even greater number of notifications, hence increase obstacles to foreign investments, and importantly indicates a willingness on the part of the German government to put even tighter screws on FDIs. Since such an amendment would not require the consent of the German parliament, it may be brought about relatively quickly but has in any case not yet taken effect. It is, however, expected to come into force later this year.

This is in addition to other political measures that the German government has taken, primarily against the rising number of Chinese investments, in the past. The case of *50Hertz*, for example, concerned the proposed acquisition of a 20% stake in the German transmission grid operator by State Grid, a state-owned Chinese company, hence not meeting the 25% threshold that would trigger a review procedure. There, the German government prevented the acquisition by itself (through state bank KfW) indirectly acquiring the stake which was for sale. It hence becomes apparent that even non-notifiable transactions may be on the government's radar, particularly where businesses operating critical infrastructure are involved.

Nevertheless, stringent control regimes appear to be a more general phenomenon. In fact, similar procedures exist in France, the UK, and the US. There have even been proposals for a review system at European level, the details of which still remain to be seen.

PRACTICAL CONSEQUENCES AND OUTLOOK

It remains to be seen to what extent the envisaged lowering of the current threshold from 25% down to 15% will have an impact on Chinese investments in Germany as in many cases Chinese investors seek to acquire majority control.

However, in any event, manifold lessons may be learned from recent cases:

Firstly, given the potentially greater number of notifiable acquisitions and ensuing in-depth examinations, review periods tend to be longer, hence should be better taken into account at an early stage of the acquisition process, for instance by including relevant provisions in the SPA.

Secondly, against the background of tighter investment controls, a bidder's offer may be put in an unfavourable light if it is subject to such scrutiny. In order to be

competitive, the bidder may therefore need to account for the administrative burden accepting its offer would necessarily entail and adjust its offer accordingly.

Thirdly, it may be observed that recent clearance decisions tend to be accompanied by certain remedies on the part of the acquirer in the form of public law contracts. Acquirers thus ought to be prepared to offer remedies to the German government.

And finally, it shall be pointed out that the review process is to a great extent politically influenced. The final decisions are neither published nor open to judicial review. The risks involved should therefore be borne in mind and uncertainty be factored into deal-making from the outset.

Whilst the latest decisions are admittedly unfavourable for foreign investors, they reflect the current political environment. Acquirers are, therefore, advised to continue to keep a close eye on the future development, which is hoped not to be too protectionist in nature.

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