GERMAN GOVERNMENT'S ENHANCED SCRUTINY OF RECENT CHINESE-GERMAN M&A TRANSACTIONS – A TURNING POINT OR JUST A TEMPORARY RESENTMENT?

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So far this year, Chinese companies have announced a record-breaking US$11 billion of M&A transactions in Germany. However, the decision of the German Federal Ministry of Economics and Technology ("FMET") to have a more in-depth review of two recent acquisitions of German companies by Chinese acquirers is casting a shadow over this recent trend. At the same time (and just ahead to his official visit to China), German Minister Economics and Technology, Sigmar Gabriel, has been advocating enhanced foreign investment restrictions by the EU. Such restrictions could potentially apply if the acquirer is a state-owned company, if the acquirer's government has ordered or funded the acquisition, if the acquirer's home country restricts foreign investments, or if the acquisition is influenced by industrial policies.

Against the background of these developments, there have been numerous public discussions whether Germany has now reached the turning point of its very liberal policy towards foreign investments, in particular, those from China. To give an answer to this question, it is necessary to first take a closer look at the current legal situation in Germany in respect to foreign investments by non-EU acquirers.

REVIEW OF FOREIGN INVESTMENT TRANSACTIONS UNDER THE FTA

Under the German Foreign Trade Act (*Außenwirtschaftsgesetz*) ("FTA"), the FMET has the right to review certain direct or indirect investments in businesses based in Germany and impose restrictions or even prohibit such investments if they threaten the public order or security. An investment is subject to such review if the investor is from outside the EU or 25% or more of the voting rights in the investor are owned by a shareholder from outside the EU and, following the transaction, the investor directly or indirectly holds 25 % or more of a German company's voting rights.

Except for the acquisition of any defense contractor or encryption software provider, the FTA does not require a formal registration or notice of a transaction. The FMET must obtain its information on foreign investments in German companies from press releases or through cooperation with the German Federal Cartel Office or the Federal Financial Supervisory Authority.

After having learned about a foreign investment in a German company, the FMET may initiate a review of such investment within three months from the signing of an acquisition agreement or the announcement of a takeover bid. If the FMET does not take any action within such three-month period, the transaction is deemed to be cleared

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and, therefore, no longer subject to further review. Should the FMET initiate a formal review process, the investor must submit to the FMET all necessary information concerning the contemplated transaction, including information about its ownership structure and the transaction's strategic intentions. The FMET then has a further two months from the receipt of the complete information to prohibit the transaction or to impose restrictions or conditions on the grounds of maintaining public order or safety.

To avoid legal uncertainty, however, and to shorten the review period, the foreign investor may request a legally binding no-objection letter prior to the transaction (whitewash procedure) by voluntarily giving notice of the transaction to the FMET. In this case, the FMET has one month from the receipt of such notice to initiate a formal review of the transaction, which is otherwise deemed to be cleared. The parties to an acquisition agreement often take advantage of this concept by incorporating into the deal documentation a covenant to notify the transaction to the FMET.

As stated in the explanatory memorandum to the FTA, the restriction or prohibition of a transaction is only possible in rare and exceptional cases. A transaction may only be restricted or prohibited if it "threatens the public order or safety of the Federal Republic of Germany," and any such decision of the FMET may be challenged before German courts. This is because Articles 52 and 65 para. 1 of the Treaty on the Functioning of the European Union ("TFEU") provide that any restrictions of the free movement of capital within the EU can only be justified by public order and safety. When interpreting the phrase "threat to the public order or safety," the European Court of Justice has, to date, upheld restrictions on the free movement of capital only in a few cases and under extremely limited circumstances. Consequently, despite its broadness, the phrase will have to be fairly narrowly construed.

TURNING POINT OR JUST A TEMPORARY RESENTMENT? – FUTURE RESTRICTIONS ON M&A CHINESE-GERMAN TRANSACTIONS

Against the background of the limitations under Articles 52 and 65 para. 1 of the TFEU, it becomes clear why any new impediments of foreign non-EU investments into Germany would need to be implemented on a European level. Otherwise, it would not be very difficult to circumnavigate any such unilateral restrictions by just using another EU company of the non-EU acquirer to make the acquisition in Germany. Whether or not the other EU countries will take the same position as Germany and support the introduction of new investment restrictions remains to be seen.

Also, we should take a look at the motives of the FMET as far as they have been made known to the public. While there were reports in the German press that in at least one of the above referred two M&A cases the revocation of the FMET's prior approval of the transaction and its reopened review was the result of an intervention by U.S. intelligence agencies that raised military security concerns, it seems that FMET's primary motive was a completely different one: according to the latest public statements of the German Minister for Economics and Technology, Sigmar Gabriel, he wants to encounter China on an eye-to-eye level, urging it to further open its own market for foreign investments and to remove its existing investment hurdles, such as the requirement of joint ventures for investments in the automotive industry.

The recent interest of Chinese companies in acquiring German technology on the one hand and the latest plans of the Chinese government to introduce further restrictions on foreign investments in the automotive industry on the other hand provided the ingredients for what now looks like a classic trade conflict. Thus, the current debate in

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Germany is only to a small extent focused on safeguarding national security interests and instead focused on the creation of a level playing field for existing and further EU investments in China. In that sense, the FMET's regulatory actions can be seen as a lever to trigger a political discussion with China's regulators with the wider objective of further reducing trade and investment barriers in China. So far, China has not indicated a reconsideration of its position and points to the fact that the volume of Chinese investments in Germany has not even reached 10% of German investments in China.

Returning to the question of a turning point or just a temporary resentment, we believe Europe and China will find a solution for their current trade conflict. If that is the case, further EU restrictions on M&A transactions by non-EU investors are unlikely and the number and level of the FMET's regulatory actions against Chinese-German M&A transactions will go back to normal.

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