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Germany and Austria: Broad measures

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New legislation in Germany can prohibit investors outside Europe from buying more than a 25% stake in a German business. Philip Martinius and Jan Querfurth report on the effects this amendment could have on M&A

On April 24, 2009, almost unnoticed by the public, an important amendment to the German Foreign Trade and Payments Act (Aussenwirtschaftsgesetz - AWG) entered into force. The amendment materially impacts a significant number of transactions involving German businesses and allows the German Federal Ministry of Economics and Technology (MET) to prohibit investors outside Europe from buying German enterprises or voting stakes of 25% or more in German companies if such acquisitions constitute a threat to the security or public policy of the Federal Republic of Germany.

While most acquisitions are likely not to be adversely affected, the scope of the new law is potentially broad, and investors from outside Europe should be careful to take the appropriate steps when structuring acquisitions where German businesses are involved. While comparable restrictions existed already for enterprises producing certain weapons or cryptographic systems, the new rules are not limited to specific industries.

Scope of application

The new restrictions apply to the acquisition of German enterprises or the acquisition of a direct or indirect participation in such enterprises, unless the voting share of the investor following the transaction is less than 25%. Voting rights held by other entities are added to the investor's votes if the investor holds 25% or more of the vote in such other entities, or if there is an arrangement regarding the exercise of voting rights. In summary, the requirement applies to share deals, but also other transaction structures that result in a foreign investor obtaining 25% or more of the voting rights in a German company, whether directly or indirectly, and whether individually or acting in concert. Likewise, asset deals fall within the ambit of the new law.

The new rules apply only to acquisitions by foreign investors from outside the European Union (EU) and the European Free Trade Association (EFTA). Investments made by entities from within the EU or EFTA are also subject to the new rules if a shareholder from a third country holds 25% or more of the voting rights of such entities and if there are, in addition, indications that an abusive arrangement or circumvention transaction has taken place in order to avoid an examination by the MET.

While this last requirement seems to indicate that investments into Germany through a European entity are exempt if there is no indication of a circumvention transaction (e.g. because a Luxembourg entity would have been chosen anyway for tax reasons), it is prudent to assume (at least until MET has developed an established practice) that such investments may still be subject to review under the new law. Any such limitation would otherwise exclude from the law a significant portion of the transactions that are potentially relevant. It should be noted that the new rules also apply to transactions regarding non-German targets that have subsidiaries or assets in Germany.

Threat to security or public policy

An acquisition is only subject to the new rules if it threatens the public policy or the security of the Federal Republic of Germany. The law explicitly refers to Articles 46 and 58 of the Treaty Establishing the European Community (EC Treaty), where similar terms are used as exceptions to the freedom to provide services or form an establishment in another member state.

Since the European Court of Justice (ECJ) interprets these terms narrowly, this reference confirms that the new rules only prohibit transactions in exceptional circumstances, although the member states have a limited discretion as to which circumstances involve a threat to public policy or the security. The law further specifies that there must be a genuine and sufficiently serious threat affecting one of the fundamental interests of society. For example, the ECJ has expressly recognised that public security is affected when it comes to securing the provision of telecommunication or electricity services in the event of a crisis. This may become particularly relevant in the case of certain infrastructure deals or investments in security-related industries that are not covered by the narrow scope of the industry-specific rules that have been in existence before.

Procedure

The buyer and the seller are under no obligation to make any filings and they are entitled to proceed with the transaction without clearance (i.e. there is no stand-still obligation as in merger control proceedings). In such a case, however, they bear the risk that the MET will decide to examine (and potentially prohibit) the transaction. If it examines the transaction and concludes that there is a serious threat to the public policy or security, then it may, upon prior approval of the Federal Government, prohibit the transaction or issue specific orders in this respect. Any purchase agreement signed without clearance is valid, but will become automatically ineffective if the transaction is prohibited.

The MET can decide to initiate an examination of the transaction within three months of the signature of the purchase agreement or, in case of a public offer, of the publication of the decision to make the public offer. While there is no general obligation to notify parties, in public takeovers and in all transactions that require antitrust approval, the MET will automatically be informed by the Federal Financial Supervisory Authority (Bundesanstalt fur Finanzdienstleistungsaufsicht - BaFin) or the Federal Cartel Office (Bundeskartellamt), respectively.

If it does decide to examine the case, the purchaser is ordered by administrative act to provide all necessary documents for the examination. It is not yet clear what documents are usually required for the examination, as the MET has yet to specify and publish a list of the necessary documents in a general decree. We assume that the examination requires roughly the same documents as were already required in the past for cases in which a producer of weapons or cryptographic systems was acquired.

After the MET receives all documentation, it has two months to determine whether to prohibit the acquisition or issue other orders to safeguard the public policy or security. If the MET does not issue any prohibition or other order within those two months, the acquisition can no longer be restricted.

In addition, the purchaser may, at an early stage, even prior to signing, apply for a certificate of non-objection with the MET if the purchaser believes that neither the security nor public policy is affected by the proposed acquisition. The application must describe the planned transaction, the purchaser and the purchaser's field of business. Upon receipt, the MET has one month to issue the certificate or open examination proceedings. If the MET does neither within the one month period, the certificate is deemed to have been issued. Once the certificate is issued or deemed issued, the MET can no longer prohibit or restrict the acquisition. Note that the certificate should only be sought when the relevant terms of the transaction are sufficiently clear in order to avoid that subsequently, the relevant circumstances change to a degree that could put the effect of the certificate in doubt (e.g. when the purchaser changes the plan and decides to acquire 50% instead of only 25%, of the voting stock).

Effects on M&A transactions

In practice, most acquisitions will not be subject to examinations by the MET under the new rules. In very clear cases that obviously do not pose a threat to public policy or security so that the risk of prohibition is only theoretical, it may be possible to ignore the rules and decide not to even apply for a certificate of non-objection.

Due to the potentially broad scope of the new rules, however, it is not yet certain when a transaction will pose a threat to public policy or security. Therefore, if there is a more than remote risk that the transaction could be examined by the MET, foreign investors should consider applying for a certificate of non-objection sufficiently in advance. The certificate is a good method of obtaining certainty within a relatively short period of time without the obligation (at least initially) to provide extensive information or documentation to the MET.

If a foreign investor realistically expects that a transaction may indeed adversely impact the public policy or security of Germany (e.g. as with certain infrastructure transactions), the foreign investor might not just apply for a certificate (which may be denied in such cases), but might also decide to obtain certainty by voluntarily providing all necessary information for an examination proceeding to the MET and thereby triggering the two month examination period. Such a step can help to accelerate the proceedings in situations where there is a risk that the certificate would be denied.

As it is typically impractical to unwind a transaction after closing has occurred, the parties may decide to further delay closing until certainty has been obtained by inserting an appropriate condition precedent and covenants requiring co-operation during the procedure outlined above.

In many instances, in particular with regard to the scope of application and the attribution of voting rights, it is still hard to predict how the MET will apply the new rules. This will change once the MET establishes its practice in the next months.

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