

Interview with: Anna Schwander

Decreased transaction security for Chinese investors

For the first time, German government prohibits transaction

Mrs. Schwander, with Leifeld, the German government has for the first time prohibited the acquisition of a German company by a Chinese investor, although only as a matter of precaution. What are the reasons for this?

The authorization of the Federal Minister of Economics to prohibit the acquisition was based on the German Foreign Trade Ordinance (*Außenwirtschaftsverordnung* - AWV), which in this case was applicable due to a planned acquisition of more than 25% of the voting rights in Leifeld - unlike the planned acquisition of the transmission system operator 50Hertz by the Chinese state-owned company SGCC. According to the government, the acquisition would have jeopardized the security interests of the Federal Republic of Germany. Since the specialized machine tools produced by Leifeld may also be used to produce components for the nuclear industry, it was feared that the military Chinese nuclear industry might benefit from the acquisition.

Are the government's rulings meanwhile stricter since also other countries increased the barriers?

Since the German Foreign Trade Act has taken effect in 2004, the German government has not prohibited any acquisition of a company on this basis. However, the amendment of the AWV in July 2017 already suggested that the German government would like to take a closer look at acquisitions of German companies by foreigners. Due to the growing concern that Chinese companies are increasingly buying state-of-the-art technologies in Germany, it was only a matter of time until reactions like those in the case of Leifeld and 50Hertz occur.

How is the international understanding?

Not only individual member states of the European Union have enhanced the foreign investment control proceedings. Also at the level of the European Union, a regulation regarding the review of foreign investments has been drafted and is expected to be finalized by the end of 2018. The draft provides for a harmonized framework and establishes EU-wide transparency as well as a cooperation of the member states in the foreign investment review process. The United States have also tightened the control mechanisms. The Foreign Investment Risk Review Modernization Act (FIRRMA), which will become effective shortly, further extends the jurisdiction of the Committee on Foreign Investment in the United States (CFIUS) to review transactions.

How does current law assess the interventions?

Currently, a prohibition of a company acquisition may only be based on the AWW, and only if the acquirer purchases at least 25% of the shares. In other cases - and as the case of 50Hertz demonstrates - an intervention of the government can only be achieved by taking on considerable financial risks. It is currently being discussed in politics to lower the participation threshold required under the AWW. However, whether lowering the threshold is sufficient, is questionable, since even minority investors may have access to essential business information of a company in certain circumstances, for instance through a member n the supervisory board or through information rights as a shareholder of a GmbH. On the other hand, it may not be denied that the described developments have already led to a reduction in the investment volume of Chinese investors in Germany, the EU and the US in 2018 compared to the previous year. Any tightening of the foreign investment control will therefore also have consequential effects.

What do you advise German companies that consider a Chinese investor as an opportunity?

The transaction security for Chinese investments in Germany has noticeably decreased since the amendment of the AWW last year. German companies, which are considering the entry of a Chinese investor, should therefore deal with the issue of foreign investment control at an early stage. Among other things, this includes the consideration of any foreign investment control procedures in the timing of the transaction as well as the inclusion of appropriate regulations (closing conditions, break-fee, etc.) in the documentation.

Dr. Anna Schwander is a partner at Kirkland & Ellis in Munich. Sabine Wadewitz asked the questions.