GERMANY AMENDS REGULATORY FRAMEWORK FOR M&A TRANSACTIONS: ONE STEP FORWARD, ONE STEP BACK?

March 25, 2009

To Our Clients and Friends:

The German legislature recently passed two pieces of legislation that significantly affect the regulatory framework for M&A transactions involving German companies:

- an amendment to the German merger control provisions, introducing an additional domestic turnover (sales) threshold that likely will reduce the number of M&A transactions subject to merger control in Germany; and
- an amendment to the German Foreign Trade Act (*Außenwirtschaftsgesetz*, "AWG"), allowing the federal government to prohibit foreign investors from buying stakes of 25% or more in German companies if such acquisitions would endanger public order or public security.

ONE STEP FORWARD: ADDITIONAL DOMESTIC TURNOVER THRESHOLD FOR MERGER CONTROL

Effective March 25, 2009, an additional domestic turnover threshold of €5 million was introduced. The German merger control law, as amended, now requires that three, instead of two, minimum turnover thresholds be met before notification of the German Cartel Office is required. Specifically, a transaction now will be subject to German merger control restrictions if, in the financial year preceding the transaction, *(i)* the participating parties' combined worldwide turnover exceeded €500 million, *(ii)* one party's German turnover exceeded €25 million, and *(iii)* another participating party's German turnover exceeded €5 million.

Relevance for foreign M&A transactions. This amendment is expected to reduce significantly the number of M&A transactions that require a merger control notification in Germany. Previously, filings notifying the German authorities of business combinations were required to be made if only one party had a domestic turnover of more than €25 million and if the transaction had a "domestic effect" — a principle construed very broadly by the German Federal Cartel Office and the courts. As a result, even acquisitions of companies with little or no or market presence in Germany sometimes triggered a notification requirement.

Broad scope of German merger control. Even after this amendment, German merger notification requirements are still easily triggered, compared to many other countries.

First, the turnover thresholds are relatively low. Second, merger control may be triggered if as little as 25% or less of the voting rights of a target are acquired. Third, the turnover of companies holding 25% or more of the shares of the target must be included and not just the turnover of the target and the acquirer, when analyzing whether the turnover thresholds that trigger notification have been met. (Example: Companies B, C, D and E each own 25% of the shares in target T. E sells its shares in T to acquirer A. Not only is the turnover of acquirer A and target T relevant to the calculation of whether the notification threshold has been met, but also the turnover of companies B, C and D will be relevant.)

ONE STEP BACK: FOREIGN INVESTMENT SUPERVISION

On March 6, 2009, the second legislative chamber (*Bundesrat*) approved a highly controversial amendment to the AWG. This amendment had previously been adopted by the German Parliament (*Bundestag).* The amendment will become effective on the day following its promulgation, which is anticipated for the end of April 2009.

KEY ISSUES

Under the amendment, the federal government can interfere with a proposed acquisition of interests in a German company if *(i)* a foreign investor *(ii)* acquires at least 25% of the voting rights in any German company, and *(iii)* such acquisition may endanger the public order or public security in Germany. At present, the law only imposes restrictions on M&A transactions involving the acquisition of producers of weapons, munitions, cryptographic systems or high-quality terrestrial reconnaissance systems, where it is determined that such restrictions are necessary to safeguard Germany's vital security interests.

Foreign investors. An acquisition by an investor from outside the European Union or the member-states of the European Free Trade Association ("EFTA States") is potentially subject to review. Also, an acquisition by a company based in the European Union or the EFTA States may be subject to review if a foreign investor directly or indirectly holds at least 25% of the voting rights in such a company and if there is an indication that this shareholding is designed to circumvent the foreign investment rules (*e.g.*, by means of establishing a letterbox company).

Type of acquisitions. Acquisitions of 25% or more of the voting rights in a German company are subject to review. To determine whether foreign participation in the German target company meets the 25% threshold, any voting shares in the target held by persons that are owned 25% or more by the acquirer must be taken into account.

Sectors most likely affected. Government supervision of acquisitions by foreigners is no longer limited to specific sectors. In practice, however, it can be expected that investments in infrastructure or services of public interest or strategic importance (*e.g.*, telecommunications and energy networks) will be most relevant for review. This is because the interpretation of "public order" and "public security" must comply with the requirements of Articles 46 and 58 para. 1 of the EC Treaty. These rules permit restrictions, on the freedoms of establishment and capital movement, for public order or public security reasons only under specific conditions. According to the current jurisprudence of the European Court of Justice ("ECJ"), for these fundamental freedoms to be restricted, there must exist an actual and sufficiently severe risk that affects a basic interest of society, *e.g.*, the need to safeguard supply in the sectors of telecommunications and electricity in the event of a crisis. The ECJ has consistently held that general economic, financial or labor market policy concerns are not sufficient justifications for restrictions on the grounds of public order or public security.

Procedure. Surprisingly, the amendment does not impose a notification requirement. Instead, the Federal Ministry of Economics ("Ministry") must rely on information made available by the Federal Cartel Office, the Federal Financial Supervisory Authority or public sources in order to review an acquisition *ex officio*. The Ministry must decide whether to review an acquisition within three months upon the signing of the sale and purchase agreement or, in the case of a public offering, upon the publication of the decision to launch a takeover bid or the publication of the acquisition of control ("preliminary review period"). Having informed the purchaser of such a decision, the Ministry can require the purchaser to provide it with the complete acquisition documentation. Upon receipt, the Ministry has another two-month period to restrict or prohibit the acquisition ("review procedure period"). Should the Ministry come to the conclusion that the acquisition endangers public order or public security, it may, with the prior consent of the federal government, impose certain obligations on the purchaser or even entirely prohibit the acquisition. Decisions of the Ministry are subject to review by German courts.

Impact on M&A transactions. As noted above, the AWG, as amended, neither imposes a notification requirement nor is the consummation of an M&A transaction subject to prior approval. However, the transaction may need to be unwound if prohibited by the Ministry. The transaction will be deemed to be subject to a condition subsequent of not being prohibited by the Ministry until the review periods have expired. If the Ministry does not initiate a review procedure within the initial three-month preliminary review period, or (assuming it has initiated a review within such three month period) does not render a decision in the subsequent two-month review procedure period, the acquisition is deemed to be unconditionally effective.

Deal certainty. In order to obtain deal certainty, an acquirer may apply to the Ministry for written approval prior to the signing of the contemplated transaction. In practice, this may

be advisable with respect to acquisitions that could "raise eyebrows," *e.g.*, investments in infrastructure or services of public interest or strategic importance. If there are no objections, the Ministry may, upon written request of the acquirer, issue such an approval. An approval is deemed to be given if the Ministry does not initiate a preliminary review proceeding within one month upon receipt of such an approval request.

The federal government has explained that, while Germany remains open for investment, it must have measures at its disposal that allow it to examine "problematic investments with regard to Germany's security." Since the Cabinet of Chancellor Angela Merkel in August 2008 had approved the draft bill amending the AWG, it has attracted heavy criticism. Moreover, the amendment raises legal concerns as to its compatibility with European Community Law. Not surprisingly, the European Commission has already announced its intention to review the amendment.

This memorandum contains only a brief summary of the new legislation and is not intended to be legal advice. Please do not hesitate to contact us with any questions.

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