

FOCUS

New German foreign trade laws could hit defence sector investment

As the sale of BAE Systems' subsidiary Atlas Elektronik continues — with a host of European and US bidders looking to acquire the company — questions are being asked across the EU and in the US about how to protect key strategic businesses.

Dr Dirk Besse, a partner in the law firm Hogan & Hartson Raue — which includes EADS, General Dynamics and Lockheed Martin among its clients — looks at recent changes to foreign investment regulations in Germany and argues that these could affect levels of investment in the defence sector.

FOR some time, companies in the German defence sector have enjoyed an increase in investor interest. In July 2004, the interest from foreign investors brought about a change in German legislation. The Foreign Trade and Payments Act (Außenwirtschaftsgesetz — AWG) and the Foreign Trade and Payments Regulation (Außenwirtschaftsverordnung — AWW) now include a provision that states that the acquisition of a German armament company by a foreign investor has to be notified and can be prohibited.

However, this was not really surprising given that the provision is applicable only to the acquisition of weapons manufacturers.

Producers of so-called dual-use goods are, for the first time, subject to the notice requirement and to the veto option. Furthermore, the German government demonstrated its ability to intervene in any sales processes, blurring the existing distinction between security and industrial policy.

Notice and veto — legal procedure

According to German foreign trade law, the acquisition of more than 25 per cent of the voting rights in a German company producing armaments, ammunition or cryptographic programmes has to be reported to the Federal Ministry of Economics and Labour.

Since September 2005, the acquisition of shares in a company producing engines and gear systems for powering tanks is also subject to this notice requirement (Sections 7 of the AWG and 52 of the AWW).

The Federal Ministry of Economics and Labour can prohibit the acquisition during a one-month period after receipt of the notice if such an acquisition is against the essential security interests of Germany.

Any prohibitions will always be preceded by co-ordination between the affected ministries. A suit may then be filed against the prohibition by the affected parties before the administrative court. While the courts usually

offer considerable scope of evaluation to the German government for assessing national security interests, they do monitor whether the main procedural principles have been observed and whether the veto decision was



■ Germany's HDW shipyard became wholly owned by EquityOne in 2002.

influenced by issues outside national security — for example, employment issues.

If an intended acquisition is wrongfully prohibited, the affected party might be entitled to damages from the German government subject to the German legal concept of liability of public authorities and officials (Staatshaftungsgrundsätze).

EU legal guidelines also have to be observed. Although the EC Treaty contains a universal exception for the defence and security interests of the Member States (Article 296 of the EC Treaty), its scope is unclear. Efforts are

being made within the EU to ensure that these areas also become subject to the regulations of the Common Market. The EU Commission, for example, has for a long time criticised French plans to establish an even more extensive regulation in order to protect French strategic industries from foreign takeovers.

Investment problems

For foreign investors, and also for German companies in which non-resident companies have at least a 25 per cent share, there are uncertainties with regard to acquiring shares in German companies within the defence sector.

These uncertainties stem from two sources. Firstly, in addition to the prohibition currently in force, further prohibition options may be introduced at any time. This would mean that an acquisition may be at risk of being vetoed not only if a target company manufactures armaments in a broad sense, but also if a company produces dual-use goods only.

In order to ensure more secure options for the proposed transaction, non-resident investors should make enquiries with the German government as to the political implications of the acquisition.

Secondly, insecurity also results from previous experience of the application process in relation to existing provisions. In contrast with the original intention of the German foreign trade law, which explicitly permits such restrictions in order to protect "substantial security interests", the German government has so far not only been guided by interests relating to security policy but also by those relating to the labour market and industrial policy.

Conclusion

For foreign investors, the acquisition of German companies in the defence or armament supply sector is subject to extensive restrictions. To a certain degree, these restrictions are politically motivated and may even be extended to the proposed transaction during the negotiations. This is also the case for investments made in German companies already controlled by non-domestic shareholders.

Conversely, the search for investors is made more difficult for German companies in the affected industries. ■

RECENT INVESTORS IN THE GERMAN DEFENCE INDUSTRY

- EquityOne bought German submarine shipyard HDW. Original 75 per cent stake increased to 100 per cent in 2002.
- Investment group Kohlberg Kravis Roberts (KKR) acquired MTU Aero Engines in 2004.
- BAE Systems, at the time of going to press, was continuing to consider offers for its German marine subsidiary, Atlas Elektronik. Thales, the EADS and ThyssenKrupp joint venture, and L-3 Communications are the current contenders.