German foreign investment authority takes off the gloves

Regulator stops acquisition of Leifeld Metal Spinning and partial acquisition of 50Hertz by Chinese investors on grounds of public security

On 1 August 2018, Yantai Taihai (**Yantai**), a leading player in China for nuclear casting and forging products, withdrew its foreign investment notification to the German Government regarding its proposed acquisition of the medium-sized German company Leifeld Metal Spinning AG (Leifeld). Without Yantai's withdrawal, the German Government would have prohibited the acquisition, which would have been the first ever prohibition of an acquisition of a German company by a non-EU/EFTA investor under Germany's foreign investment regime (under which more than 400 cases have been reviewed in the last ten years). As a matter of precaution, the Government has nonetheless decided to authorize a prohibition while examining whether the deal was effectively abandoned by Yantai.

Just days prior to this, the German Government intervened when Chinese state-owned State Grid Corporation of China (**SGCC**) attempted to acquire a minority stake of 20 per cent in 50Hertz, a German power grid operator, which eventually put SGCC out of the race for the minority stake for the second time. This case makes it clear that the German Government puts particular focus on state-owned groups and other non-European investors with strong government backing.

Although these developments follow amendments to Germany's foreign investment regime in July 2017 (see our earlier briefing), it is worth noting that the amendments did not change the standard of review of foreign investments. It is rather the changed mind-set and the public awareness of foreign investments that have made the German rules tougher in practice.

In its reviews, the German Government is also guided by the federal intelligence agency of Germany. The agency's annual report, published in July 2018, explicitly referred to the "Made in China 2025" initiative and the potential threat to sensitive data and know-how, the outflow of which could affect German security interests. The report states as follows:

"The aim of the program [i.e. Made in China 2025] is to develop the country into a leading industrial nation. To this end, specific sectors and technologies of the future are specifically promoted (including marine and shipping, railway technology and railways, new energies and propulsion, new materials, medical technology, smart manufacturing and industrial robotics, information technologies, aviation and aerospace technology). The Chinese state influences, steers and controls investments through investment permits, strict capital controls, selective lending, close coordination between state-owned enterprises and the government, as well as certain Party cells in Chinese companies (influencing the corporate governance). The intelligence services are also involved in this way."

Key points to note

- The German Government and the Ministry for Economic Affairs and Energy (the **Ministry**) are willing to intervene to prevent foreign investments in sensitive areas;
- Even minority investments are looked at sceptically, in particular, where so-called critical infrastructure is at stake ("critical infrastructure" includes facilities in a range of sectors, including energy, information technology and telecommunications, transport and traffic, health, water supply, food, as well as finance and insurance, provided that they meet certain materiality thresholds);

- Acquisitions by buyers linked to foreign governments (in particular the Chinese Government) appear to be of particular concern. However, the Ministry generally treats all acquisitions the same way so that investors with governmental links from any country have been subject to closer scrutiny;
- It seems likely that the German Government will, at least for certain sectors, lower the thresholds to be able to investigate minority acquisitions below the current 25 per cent shareholding threshold;
- Thorough foreign investment due diligence at an early stage becomes more and more important in M&A transactions.

Yantai Taihai/Leifeld

The Chinese company Yantai, a leading player in China for nuclear casting and forging products, intended to acquire the German company Leifeld Metal Spinning AG (Leifeld). Leifeld is a German machine tool manufacturer with sites also in the USA, China and Russia and generates approximately EUR 40 million sales with about 200 employees. After several months of review, the German Government found that the proposed acquisition would put the public order or safety in Germany at risk.

Yantai also reported this week that its anticipated takeover of the French company Manoir, in which Yantai already holds a major stake, was prohibited by the French Government. Yantai apparently intended to route the acquisition of Leifeld through Manoir which is active in metal processing focusing on high tech casting and forging components for the petrochemical, nuclear and other sectors.

Decisions on German foreign investment reviews are kept secret and the Government has not published any detailed concerns. But the Ministry will have taken into account that Leifeld is a technology leader for machine tools that can process high-strength materials (such as titanium steel) to manufacture components for the aviation and aerospace industry. Such material could well be used in the defence sector and the armed forces in Germany. In recent cases, dual-use products and defence supply relationships were a particular concern for the German Government.

It has also transpired that Leifeld's machines are used by its customers to produce certain parts for civil rockets and the nuclear sectors. This raises nuclear-related concerns similar to those in the attempted public takeover of Aixtron SE (**Aixtron**) by the Chinese investment fund Fujian Grand Chip (FGC) in 2016, where the Ministry first cleared the case but later revoked the clearance after new facts came to light. It was reported that a US intelligence agency informed the German Government that Aixtron's products could be used in China's nuclear program. However, unlike in the Leifeld case, the Ministry did not have to take a final decision as Barack Obama, the US President at the time, prohibited the acquisition of Aixtron's US business which led to FGC abandoning the entire transaction.

SGCC/50Hertz and Geely/Daimler

The German Government also recently intervened in the planned acquisition of a 20 per cent stake in 50Hertz, a leading German power grid operator with approximately 18 million connected users. Despite regulatory changes in July 2017, which defined power grids as "critical infrastructure", the German Government was unable to review the proposed acquisition by SGCC under the foreign investment law, because acquisitions of shareholdings smaller than 25 per cent are not subject to review.

This was also the reason why Geely's acquisition of 9.6 per cent of Daimler was not reviewed by the Ministry, which was caught by surprise when Geely announced the transaction. Based on these cases and other recent foreign investments, some politicians have suggested lowering the 25 per cent threshold to enable the Ministry to review (and prohibit) more transactions that involve critical infrastructure. Although this seems likely to happen in the future, these plans have not materialised so far.

In the 50Hertz case, the German government, therefore, chose a different route. It used its political influence and, in the end, the German state-owned bank KfW to purchase the stake with the help of Elia's (50Hertz's majority shareholder) pre-emption right.

The Australian investor IFM originally held a 40 per cent stake in 50Hertz. When IFM put the first tranche (of 20 per cent) up for sale in late 2017, the German government purportedly urged Elia to use its pre-emption right to oust the Chinese state-owned company SGCC. When IFM put its remaining 20 per cent stake in 50Hertz on the market earlier this year and SGCC renewed its interest in this investment, the German Government was still unable to review the transaction under the foreign investment law. It now appears that the Government again convinced Elia to exercise its pre-emption right also for this stake and to immediately sell the 20 per cent tranche to the KfW, thereby ousting SGCC for the second time.

When the German Government announced the transaction it explicitly justified the move with considerations of security policy, most notably a reliable power supply, and stated that this was just an interim solution until a new investor could be found.

Broader Context

These three cases are in line with the overall international trend of governments to reinforce their national security screening powers in light of a perceived threat to sensitive assets and businesses being acquired by buyers linked to foreign governments (in particular Chinese buyers) and to make use of the new toolboxes they have created. All G7 members as well as Russia have strengthened (or in the case of the US are in the process of strengthening) their foreign direct investment or public interest screening regimes since 2015, while an EU-level foreign investment screening regulation is likely to come into effect around the summer/autumn 2020 (see our earlier briefings on the UK, US, EU and Russia