ÉTUDE DROIT BANCAIRE ET FINANCIER

FOREIGN INVESTMENTS

The consolidation of the defence sector in Europe will come. The recent adoption by the french parliament of the *Macron* draft bill privatazing the french group Nexter Systems in view of its partnership with the german group KMW is a symbol. Beyond political stakes, mergers and strategic alliances in the defence industry present some legal specifics. Such specifics pertain in particular to the specific nature of the activities falling under national defence interests, the requirement to obtain certain permits or licences to conduct defence activities, which may be challenged in case of a change of control, and the characteristic of the contracts executed by defence groups, especially when co-contractors are public bodies, such as ministries of defence. This article aims to provide an overview of the legal framework of investments in the defence sector in France, the United Kingdom and Germany.

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Foreign investments in the defence sector

Legal framework in France, UK and Germany

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1 - Due to several factors, in particular relating to the reduction of defence budgets and the high competition between national defence groups, the consolidation of the defence sector will come, especially in Europe[1]. There are some forerunners. In 2012, there has been the merger attempt between BAE Systems and EADS/ Airbus group. More recently, in France, the Parliament has adopted a draft bill privatising the French group Nexter Systems in view of its partnership with the Ger-

1 See in particular *2014 Report to Parliament on French arms exports, French Ministry of Defence, August 2014 and the Livre blanc sur la défense nationale, 2013.*

man group Krauss-Maffei Wegmann (KMW) to create a leading European player in the land defence sector.[2] Also, BAE Systems and Dassault Aviation entered into a partnership with the UK and French governments to create new generation of unmanned jet[3].
Beyond political stakes, such mergers and strategic alliances present some legal specifics. Such specifics pertain in particular to (i) the specific nature of the activities falling under national defence interests, which may require the adoption of a particular regime for foreign investments in defence sector, (ii) the requirement to obtain certain permits or licences to conduct defence activities, which may be challenged in case of a change of control, and (iii) the characteristic of the contracts executed by defence groups, especially when co-contractors are public bodies, such as ministries of defence.
As a consequence, any investor wishing to acquire an interest or partner with a defence group may face regulatory constraints. These constraints will essentially depend on the precise activities of the concerned defence group, the jurisdictions in which these activities are carried out and the nationality of the investor. This article aims to provide an overview of the legal framework of investments in the defence sector in France, the United Kingdom and Germany.

2 - French law is, unsurprisingly, quite strict. The control implemented by public authorities is carried out at several levels. Thus, some acquisitions, even of a minority interest, may require the prior approval of the French Ministry of the Economy. Furthermore, public authorities are also likely to withdraw certain permits or licences required to conduct defence activities in case of a change of control of defence groups. Lastly, public procurement contracts regulations enable public co-contractors to early terminate contracts for any reason of "public interests", which could include a change of control of the private co-contractor.
On the contrary, investments in the UK defence sector are less regulated than in France. Moreover, such regulation does not derive from statutory provisions.
Finally, the legal framework of foreign investments in the German defence sector is akin to the French one: such investments are subject to strict official control. The trigger for adoption of this legislation was the takeover of the Howaldtswerke Deutsche Werft AG group (HDW - construction of conventional submarines) by US financial investor One Equity Partners in 2002 - a transaction that the German government was unable to exert any influence on at the time.

We will address, in order, the French (1), the UK (2) and the German (3) legal frameworks of investments in the defence sector.

1. Legal framework of foreign investments in the French defence sector – the protection of national defence interests

A. - The prior approval of the French Ministry of the Economy required even for the acquisition of minority stakes

3 - ***What foreign investments are subject to prior approval.*** - In order to be subject to the prior approval of the French Ministry of the Economy, investments must qualify as "foreign investment" and relate to a "sensitive" activity, according to the criteria defined by the French Monetary and Financial Code (CMF).
More specifically, the prior authorisation regime depends on the origin of the investor (EU[4] or non-EU), as this determines both (i) the scope of the operations considered as "foreign investments" and (ii) the list of "sensitive activities". The regulations are more restrictive for a non-EU investor.
Investments by a non-EU investor qualify as foreign investments if they correspond with the following operations (a) the acquisition of control, within the meaning of article L. 233-3 of the French Commercial Code, of an "*entreprise*"[5] that has its registered office in France, (b) the acquisition of all or part of a line of business of a company that has its registered office in France, or (c) the acquisition of more than 33.33% of the shares or voting rights of a company that has its registered office in France.
For an EU investor, only investments under (a) or (b) above qualify as foreign investments.
The list of sensitive activities applicable for EU and non-EU investors is detailed by the French Monetary and Financial Code (*FMFC, art. L. 151-3 and the implementing provisions ; FMFC, art. R. 153-1 and seq.*)[6]. Not only military activities are

2 Article 47-I of the draft bill "pour la croissance, l'activité et l'égalité des chances économiques" authorising the transfer to the private sector of the majority of the share capital of the Groupement Industriel des Armements Terrestres (GIAT) and its subsidiaries.

3 Such program also include Rolls Royce, Selex ES (a company of the Finmeccanica group), Safran and Thales.

4 Legal entities that have their registered offices in a Member State of the European Economic Area that has signed an administrative cooperation agreement with France with respect to certain tax matters are assimilated EU investors for the purposes of the foreign investment regime.

5 The term "enterprise" is not defined by the French Commercial Code. The EU Council defines it as the "transfer of an economic entity which retains its identity, meaning an organised grouping of resources which has the objective of pursuing an economic activity, whether or not that activity is central or ancillary" (Council dir. 77/187/EEC, 14 febr. 1977).

6 It is reminded that the list of sensitive activities not relating to the defence sector has recently been extended by governmental decree n°2014-479 dated 14 May 2014, which refers to activities in areas such as energy, water, transport, health and telecommunications.

considered "sensitive", but also activities pertaining to "dual-use" equipment[7], such as equipment relating to the security of information systems.

The prior approval of the French Ministry of Economy is required even for the acquisition of minority stakes in the defence sector

4 - **In what situations can a foreign investment consisting in the acquisition of a minority shareholding in a defence group be subject to prior approval?** - There are at least three situations pursuant to the regulations relating to foreign investments provided by the CMF. Firstly, as indicated above, where the acquisition by a non-EU investor consists in a 33.33% (or more) shareholding or voting rights in a company that has its registered office in France[8].

Secondly, where the acquisition of a minority shareholding grants the foreign investor (whether EU or non-EU) "joint-control" over the target company. A minority shareholder will be considered to jointly control another company when it holds veto rights on the strategic decisions of this company, e.g. the approval of the business plan, the appointment of the management, or other strategic decisions given the activities of the company concerned[9]. On the contrary, if the governance rights only aim at protecting the value of its investment, the foreign investor will not be considered as jointly-controlling the target company.

Thirdly, it can also be the case where a foreign investor (whether EU or non-EU) acquires a minority interest in a partnership having no share capital governed by French law.

Partnerships in the defence sector can be organized under Economic Interest Grouping (*Groupement d'Intérêt Economique* or *GIE*)[10].

The French Administration considered, under the previous regulations on foreign investments, that the acquisition of a minority interest in a GIE having no share capital could qualify as a foreign investment[11]. This analysis could still be relevant as the FMFC defines investments as taking control over an "*entreprise*" (and not only companies having share capital).

5 - **Could the French Administration apply other criteria to submit an investment to prior approval?**

French regulations provide that some foreign investments not subject to prior approval must be declared to the French Ministry of the Economy. According to these regulations, the granting of material financing or guarantees or the purchase of patents or licences can qualify as a "*de facto*" control[12]. It is not excluded that French regulations change such that "*de facto*" takeover of a defence group be subject to a prior approval procedure.

Finally, other grounds, not specific to the regulations relating to foreign investments, may require prior approval from the French Ministry of the Economy. It is the case where the French State holds a Golden Share, as it is the case for the Thalès group. This Golden Share comes with specific rights, such as the possibility for the French Ministry of the Economy to approve or refuse any increase of direct or indirect shareholding in Thalès, as from 10% of the share capital or voting rights.

It is important to note that the draft bill for growth, activity and equality of economic opportunities provides for the reinforcement of the rights attached to Golden Shares (article 44). Henceforth, for transactions requiring the approval of the French Ministry of the Economy, a specific threshold may be determined for acquisitions of stakes by foreign investors or under foreign control acting alone or jointly. The approval shall not be denied unless the transaction is likely to compromise France essential interests that justified the creation of the Golden Share.

As a consequence, any foreign investor contemplating acquiring or partnering with a defence group in France should, in the event of doubt concerning the applicable procedure (approval or declaration), seek confirmation from the French Administration. A ruling procedure is available for this purpose.

B - The withdrawal of permits and licences required to carry out defence activities in the event of a change of control of the defence group in favour of a foreign investor

6 - **The withdrawal of the permit to manufacture and sell war materials if the nationality condition is not met.** - Since a decree dated 30 July 2013, the French Defence Code classifies defence

7 Dual-use items are goods, software or technology normally used for civilian purposes but which may have military applications. For a complete definition of dual-use items, see Articles 2 and 4 and Appendix I of Regulation (EC) No 428/2009.

8 On the face of it, such an acquisition, if it was completed by an EU investor, would not be submitted to prior approval, except where it constitutes a takeover of the target company within the meaning of article L. 233-3 of the French commercial Code(see above the definition of "control").

9 French *Conseil d'Etat, 20 Oct. 2004, n° 260898 : JurisData n° 2004-067542. - French Conseil d'Etat, 6 july 2007, n° 283319 : Juris-Data n° 2007-072117. - French Cass. Com., 29 june 2010 n° 09-16.112 : Juris-Data n° 2010-010642 ; JCP E 2010, 1778. – P. Kasparian, Le contrôle conjoint : Joly Editions, 2014*

10 In light of its purpose, which is to "facilitate or develop the economic activity of its members and to improve or increase the results of this activity" pursuant to Article L 251-1 of the French Commercial Code, the legal form of the GIE is well adapted to partnerships in the defence sector. Airbus Industrie (1970), Euromissile GIE (1980) and Eurosam GIE (1989) formerly existed under the GIE structure.

11 Ministerial response to QE n° 23681, JOAN Q. 14 nov. 1983 p. 4883.

12 This approach was even expressed by a circular dated 15 January 1990 adopted for the implementation of decree n°89-938 relating to foreign investment, as abrogated in 2003.

products into 4 categories according to their level of danger, ranging from "A" (war materials and other weapons that nobody may purchase or hold) to "D" (weapons that are subject to registration and other weapons which may be freely purchased or held).

The manufacture or sale of category A or B defence products can only be carried out by companies having obtained authorisation from the French Ministry of Defence (*French Defence Code, art. L. 2332-1, I*). The granting of this permit is subject to certain prerequisites, including the French nationality of the applicant company.

For applicant companies that are limited by shares (*sociétés par actions*), the implementation regulations provide that the majority of the share capital must be held by French nationals or citizens of other EU or assimilated countries, and that both the legal representatives and the members of their boards shall be French nationals or citizens of other EU or assimilated countries[13].

Any changes regarding the legal structure of the permit holder, the nationality of its management or shareholders and, in particular, any transfer of shares that is likely to transfer control of the permit holder to foreign investors, must be notified immediately to the Ministry of Defence, following which the Minister may withdraw the permit[14].

7 - ***The risk of withdrawal of licences relating to the importation and exportation of defence products.*** - The legal regime applicable to the importation and exportation of war materials and assimilated materials, in force since 2014, depends on the countries of origin and the destination countries for such materials, EU or non-EU countries.

The general principle is that importations of war materials in France from non-EU countries, or exportations from France to non-EU countries, as well as transfers within the EU, are subject to the relevant company holding a licence. Such licence is granted by the Ministry of Customs for importations from non-EU countries and by the Ministry of Defence for exportations to non-EU countries and transfers between EU countries.

In principle, the granting of such licences is not conditional on the nationality of the applicant, as the objective is more to control the countries of origin or the destination countries of such war materials than it is to control the nationality of the importer or exporter.

However, the French Administration may impose at its sole discretion conditions when delivering these licences which, if no longer satisfied, may result in the licence being withdrawn[15].

Moreover, exportation of war materials licences can be withdrawn for reasons relating to France's international undertakings, or to protect national security interests, public order, or public security (*French Defence Code, art L. 2335-4*)

C. - The risk of early termination of defence public procurement contracts for reasons of public interest

8 - Defence public procurement contracts, such as those with the "*Direction Générale de l'Armement*" (DGA) may contain provisions, which impose, in case of change of control, to notify the public entity or to obtain from the public entity a prior authorization.

In the frame of defence public procurement contracts, the public entity may impose the application of General Administrative Terms (*Cahier des clauses administratives generales*)[16], which shall be read in conjunction with the Particular Administrative Terms, specific to the given public procurement, and which derogate to the General Administrative Terms.

For instance, the General Administrative Terms Applicable to French Industrial Public Contracts (*Marchés publics industriels*) provide the obligation for the co-contractor to notify the public entity of certain facts or matters occurring during the performance of the public contract, which do not make reference to the occurrence of any change of control of the co-contractor.

However, in a comment under Article 3.4.2, the said General Administrative Terms state that the Particular Administrative Terms can include the obligation to notify information relating to the shareholding, the persons or groups which control the private co-contractor, or the group to which such co-contractor belongs to, "*especially for certain defence public procurements concerned by restrictive provisions in terms of involvement of foreign companies or companies controlled by foreign groups*".

Then, pursuant to the said General Administrative Terms, the French Administration may terminate the agreement for rea-

13 *Decree n° 2013-700, 30 july 2013, art. 75 II. (b), implementing L. n° 2012-304, 6 march 2012, « relative à l'établissement d'un contrôle des armes moderne, simplifié et préventif » : JO 2 août 2013, p. 13194.* - For defence products pertaining to the category "A2" (war materials), the nationality criteria is even limited to French nationals.

14 *Decree dated 30 July 2013, previously mentioned, art. 80 and 81.*

15 The same principle applies to "dual-use" licences which, in principle, are not subject to nationality conditions. However, certain licences may be subject to specific conditions contained in the licence itself, which may relate to the identity or the nationality of the controlling shareholder of the licence holder.

16 There are different General Administrative Terms, which may apply depending on the nature of the public procurement : industrial public procurements, day-to-day supply and service public procurements, intellectual performance public procurements, public work contracts and information and communication technologies public procurements ("Marchés publics industriels", "Marchés de fournitures courantes et services", "Marchés publics de prestations intellectuelles", "Marchés publics de travaux" and "Marchés publics de techniques de l'information et de la communication").

sons of "public interest", to protect national defence interests[17]. Also, even in the absence of change of control provision or application of the said General Administrative Terms, the public entity is also, as a matter of general administrative law principles, entitled to terminate the contract for reasons of "public interest" (*résiliation pour motif d'intérêt général*)[18].
Indeed, case law considers that a change of control of a contractor could motivate a termination of the public procurement contract by the public entity if the change of control entails a conflict of interest[19].

2. Foreign investment in the UK defence sector - an unregulated practice?

9 - Against a backdrop of ever more frequent calls for governments to impose tighter controls on foreign investment in the defence sector, the UK continues to take a more *laissez faire* approach.
This approach has encouraged growth in the defence sector, as an examination of the proportion of large defence companies located in the UK displays [20]. In the period 2007-2009 over half of the total acquisitions of EU based arms producing companies involved or were in relation to UK based or incorporated defence sector companies[21].
The 'Defence Growth Partnership', a public-private body tasked with the development of the defence sector in the UK, has recently stated that "as defence spending in some markets stabilizes or decreases and other markets expand and emerge, the UK Defence Industry needs to enhance its competitiveness"[22]. The government has identified foreign investments in the defence sector as a key driver to achieve this goal[23].

UK continues to take a more « laissez faire » approach on foreign investments in the defence sector

A. - The legislative structure

10 - As a general rule, and in contrast to the position in France or Germany, there are no legal provisions in the UK governing foreign investment in the defence sector. This means that foreign investors are able to acquire a UK incorporated company (or form a subsidiary in a UK incorporated company) with the same relative ease enjoyed by companies incorporated in the UK[24].
Although there is no over-arching legislation restricting foreign investment in the UK generally, in the defence sector (amongst others), certain restrictions may be imposed. The UK follows what is referred to as 'The Review Model'[25], whereby acquisitions of companies , where they give rise to certain specified public interest considerations, may be subject to review by certain government ministries. The most relevant public interest considerations in the defence sector are in relation to national security[26].
Specifically, under the Enterprise Act 2002, the UK government may intervene, at any point in the takeover/merger process, where:
-it believes that the investment opportunity is one of importance and relevance to national security;
-one of the parties involved in the transaction is carrying out activities in the UK; and
-the contemplated investment is in relation to a company which is or has been privy to classified information[27].
Pursuant to EU Treaty[28], the UK government is not obliged to disclose the grounds for intervention where the 'public interest' criteria is invoked[29].

17 *Cahier des clauses administratives générales applicables aux marchés publics industriels, art. 29.*

18 Termination for reasons of general interest involves full compensation being granted to the contractor.

19 French *Conseil d'Etat, n° 126594, 31 July 1996, Société des téléphériques du Mont-Blanc,.*

20 More than 10 per cent of the top 100 defence companies in the world are located in the UK, and a further 20 have significant operations in the country – *ICD Research 'The UK Defence Industry – Market Opportunities and Entry Strategies, Analyses and Forecasts to 2017', feb. 2012 p. 18.*

21 *D. Flott, Safeguarding the EDTIB: the Case for Supervising non-EU FDI in the Defence Sector, Egmont Royal Institute for International Relations, December 2012, p. 3.*

22 *Defence Growth Partnership 'Delivering Growth – Implementing the Strategic Vision for the UK Defence Sector', July 2014, p. 9.*

23 *'The Kay Review of UK Equity Markets and Long-Term Decision Making'* HC 603 (2013) p.47 – *"Inward investment by foreign companies can benefit the UK, bringing in new ideas, technologies and skills, stimulating productivity and growth in UK business and opening up markets for trade. Attracting investment to the UK from around the world is a vital element of the Government's strategy to ensure sustainable long term growth".*

24 Notwithstanding this, foreign and UK investors are both subject to various monopoly and merger rules.

25 *Op. Cit. fn 20 above at p.5.*

26 For further information, see *Y. Aubin and A. Idiart, 'Export Control Law and Regulations Handbook; A Practical Guide to Military and Dual Use Goods Trade Restrictions and Compliance', Kluwer Law, 2nd Ed., 2011 p. 16.*

27 *Section 42(2) Enterprise Act 2002 : "The Secretary of State may give a notice to the OFT (Office of Fair Trading) if he believes that it is or may be the case that one or more public interest consideration (as specified in section 58) is relevant to a consideration of the special merger situation concerned".* For the purposes of the Enterprise Act 2002 (2002, c.40), *'public interest'* includes *'the interests of national security (including) public security'* as outlined in *section 58(2) of the Enterprise Act 2002.* The legislation notes that *'public security'* has the same meaning as in *Art. 21(4) of Council Regulation No. 139/2004 on the control of concentrations between undertakings (the EC Merger Regulation).*

28 *Treaty on the Functioning of the European Union, 2012/C 326/01, art. 346.*

29 For analysis of the interaction between the 'public interest' intervention and *art. 346 TFEU*, see *Case No.IV/M.1438 British Aerospace/GEC Marconi OJ 1999 C.241/8.*

Notwithstanding the above, the provisions outlined are – in practice – scarcely used in relation to foreign investment in the defence sector.

B. - Other non-statutory measures enabling the control of foreign investments in the defence sector

11 - Whilst, in contrast to France and Germany, there exist few statutory restrictions on foreign investment in the defence industry, certain other non-statutory restrictions can exist which may restrict foreign investment.

12 - **Corporate constitutional restrictions** - Restrictions on the level of foreign investments in a UK incorporated company may be provided in the company's constitutional documents. As, under UK company law, no foreign investment specific restrictions exist on the drafting of an entity's constitutional documents[30], this 'softer' non-legislative route has been used to control foreign investment.

As an example, The Companies (Model Articles) Regulations 2008[31], outline three sets of 'model' form articles of association[32] for UK incorporated companies. These apply as the default articles of association for companies incorporated under Companies Act 2006, and do not contain any restrictions on foreign investment[33].

13 - **Golden Shares** - The privatisation of a number of government controlled companies, conducted in the 1980', resulted in the UK government fearing a loss of control over these former 'national treasures'. Accordingly, over the past thirty years, the UK government has purchased so-called 'Golden Shares' in certain UK incorporated (newly privatized) companies, often for nominal value (of £1 each).

The UK government currently holds golden shares in 24 companies, with BAE Systems plc and Rolls-Royce Holdings plc represented from the defence sector. This has meant that, despite privatisation, the UK government has retained a powerful – and often controlling - stake in the company in question.

The precise rights attached to the Golden Shares vary from company to company however, as a general rule, these shares provide the right to veto in the event of foreign investment. The Golden Share typically grants the UK government a 15 per cent shareholding in the company, and consequentially the ability to block any foreign investment.

In recent years, the European Commission has challenged the UK government's holding of golden shares in certain entities[34]. In 2012, the UK Ministry of Defence agreed to modify the rights attached to its golden share in the company QinetiQ plc, resulting in it no longer being able to veto any (including foreign) investment in the company[35].

14 - **Ministry of Defence (MoD) Approval.** - Where a defence company, whether UK incorporated or otherwise, has ongoing contractual relationships with the MoD, there is usually an informal clearance process that is undertaken prior to any proposed divestment or investment.

Although the current approval procedures are not publically available, in practice, a defence company's MoD 'liaison officer' would raise the proposal with MoD in the first instance to obtain their initial view.

Notwithstanding the above statement, the MoD's powers to restrict and control the defence sector investment are broad and, as noted above, are not limited by statute.

15 - **Manufacturing, export and import of defence products under UK legislation**

UK incorporated companies involved in the manufacture, export and import of defence products are subject to numerous regulations controlling these processes and shipments.In relation to the above practice, companies are treated identically regardless of whether their investor base is domestic or foreign. Accordingly the granting of any relevant licences depends on a number of factors not connected to the nationality of the company shareholders.

3. Foreign investments in the German defence sector

16 - In Germany, cross-border investments in defence companies are subject to extensive state control - unlike in the UK. The Foreign Trade Act (*Außenwirtschaftsgesetz* - AWG) in particular and, indirectly, also the War Weapons Control Act (*Kriegswaffenkontrollgesetz* - KrWaffG) as well as regulations issued on the basis of these laws contain a number of provisions on the control of foreign investments in the defence sector.

30 *Companies Act 2006 [2006, c.46]*.

31 SI 2008/3229.

32 One 'model' form for each of (i) private companies limited by shares, (ii) private companies limited by guarantee, and (iii) public companies.

33 It is important to note that these 'model' articles can be amended in favour of fully bespoke articles of association, tailored to the specific requirements of the company in question.

34 See *Commission of the European Communities v United Kingdom of Great Britain and Northern Ireland* C-98/01 [2003-I-04641] – Rights attaching to the United Kingdom's Special Share in BAA plc. Although not specifically in the defence sector, the CJEU objected to the UK Government's right to prevent the acquisition of more than 15% of the voting shares in the company (thereby objecting to the UK Government's right to prevent FDI in BAA plc).

35 Additionally, in 2012, the UK Department for Business, Innovation and Skills agreed that its Golden Share in Rolls-Royce Holdings plc could be amended in the event of shareholder approval.

A. - Direct control of foreign investments : the prior approval of the Federal Ministry for Économic Affairs

The acquisition of German defence groups can be conditioned upon the prior approval of the Federal Ministry for Économic affairs

17 **Provisions of the AWG** - Section 5(3), sentence 1 AWG in conjunction with section 4(1), no. 4 AWG allows for the restriction of the acquisition of German companies that manufacture or develop war weapons or other defence products, or for the restriction of the acquisition of shares in such companies by non-EU buyers if these restrictions protect material security interests of the Federal Republic of Germany.

18 **Provisions of the Foreign Trade Ordinance (Außenwirtschaftsverordnung - AWV).** - The AWV sets forth the details in this respect.

According to section 55(1) AWV, orders restricting the general acquisition of German companies can be issued by the Federal Ministry for Economic Affairs. This *multisectoral* review (i.e. applying not only to the defence sector) presupposes that the "public order or security of the Federal Republic" is impaired.

According to ECJ case law this means, for example, the maintenance of state institutions, central public services and infrastructure as well as the existence of the population[36]. This could also be relevant for the defence sector.

In addition, section 60(1) AWV provides for a *sector-specific* review for the defence industry in particular which can be initiated by the Federal Ministry for Economic Affairs. This includes companies that manufacture or develop goods within the meaning of Part B of the War Weapons List (annex to the KrWffG)[37] or specially constructed engines or transmissions to power battle tanks or other armoured military tracked vehicles[38].

The object of the review procedure pursuant to section 60(1) AWV is to determine whether the relevant acquisition jeopardises "material security interests of the Federal Republic of Germany".

This concept has already been specified under European law based on Article 346(1) of the Treaty for the Functioning of the European Union (TFEU), which allows for national restrictions as an exception to European free movement of capital.

Therefore, each Member State can take such measures as it considers necessary for the protection of its material security interests insofar as they concern the production of arms, munitions and war material or the trade with such products. In this case it was important for the ECJ that an assessment of the notion must be based on objective - and not discriminatory - criteria[39].

These prerequisites are strict. In addition to the specified requirements according to European law, another reason for this is to avoid discouraging foreign investors[40].

19 - **Transactions covered by the restrictions.** - According to section 60(1) AWV in conjunction with section 56(1) AWV, the Federal Ministry for Economic Affairs can intervene in the case of an acquisition of a German company or of a (direct or indirect) participation in such a company by a foreign party. This can be done by means of an acquisition of either the activities of a company (asset deal) or of a (direct or indirect) participation in a company (share deal).

In the case of an "asset deal", to be governed by such regulation, the acquirer must end up with the actual disposal and decision-making powers in the overall business organisation[41].

In the case of a "share deal", to be covered by the restrictions, the acquirer must have direct or indirect voting rights in the German company totalling at least 25%. The spirit and purpose of this percentage is that the acquirer then generally has a blocking minority under German corporate law which he can use to influence the company.

An "indirect participation" refers to shares in a company that, in turn, has shares in a German defence company. For clarification purposes, section 56(3) AWV stipulates to this end that, together, the acquirer and the intermediate company must hold at least 25% of the voting rights. If the acquirer has concluded an agreement on the joint exercise of voting rights with another shareholder, the shareholding of such other shareholder can be aggregated to the shareholding of the investor.

20 - **The review procedure, possible obligations and restrictions.** - When it is a matter of a general multisectoral review (i.e. not only concerning the acquisition of defence companies), a review procedure can be instituted up to three months after the signing of the contract (*section 55(3), sentence 1 AVW*). In practice, for the sake of certainty, it is advisable to obtain a certificate of non-objection (*section 58(1) AVW*) from the Federal Ministry for Economic Affairs.

36 *ECJ, judgement of 10 July 1984 – C72/83 -, margin n° 34/35.*

37 *AWV, Section 60(1), n° 1.*

38 *AWV, Section 60(1), n°. 2.* - For example, missiles, guns, automatic weapons as well as ammunition and other material components are specifically listed here.

39 *ECJ, judgement of 14 March 2000 - C-54/99 Association Église de scientologie de Paris, margin n° 17/18.*

40 *Hocke/Friedrich, AWG- Kommentar, 181st update, 02/2015, section 5, margin n° 5.*

41 *Cf. Hocke/Friedrich, AWG- Kommentar, 181st update, 02/2015, section 7, margin n° 21.*

The process is different in the case of "sector-specific review procedures" (i.e. relating to the acquisition of defence companies), however. Here the direct acquirer has a duty to report to the authorities under section 60(3), sentence 1 AWV. In accordance with section 62 in conjunction with section 57(1) AWV the report must set out basic details concerning the acquisition and the acquirer, as well as the domestic company being purchased and the sectors it operates in.

Under section 62 AWV, at the end of its review, which must not take more than one month, the Federal Ministry for Economic Affairs can either prohibit the acquisition altogether (alternative 1) or impose restrictions (alternative 2). However, if the transaction is not at odds with Germany's material security interests, or if the transaction is not a relevant foreign acquisition, it will be given clearance in accordance with section 61, sentence 1 AWV. Clearance is presumed if no review procedure has been opened one month after delivery of the report.

A defence-related transaction that is completed without the required licence is provisionally invalid pursuant to section 15(3) in conjunction with section 5(3) AWG. The transaction becomes legally valid (with retroactive effect) only after the licence has been granted.

Pursuant to section 13(2), no. 2(d) AWG the Federal Ministry for Economic Affairs must take its decision in consultation with the Foreign Office and the Federal Ministry of Defence. Formally, decisions of this kind are immediately enforceable administrative acts, against which, pursuant to section 14(2) AWG, objections and actions for avoidance have no suspensory effect. If prohibitions are deemed by the courts to be unlawful, they can sue the authorities for damages[42].

B. - Indirect control of foreign investments: licences required for the activities of defence companies

21 - Besides the discussed direct restrictions on the acquisition of German defence companies by foreign investors, there are other - indirect - controls, like in France. These controls do not apply at the level of the acquisition process itself, but "one level higher", so to speak, namely at the level of the licences that defence companies require to conduct their business. If need be, these licences can be revoked in the event of acquisition by foreign investors.

22 - **Licences required for the manufacture and sale, etc. of defence products under the KrWaffG**

Under section 2 KrWaffG both the manufacture and the sale of war weapons are subject to a licence issued by the Federal Government, represented by the Federal Ministry for Economic Affairs and the Federal Office for Economic Affairs and Export Control (BAFA). Putting war weapons into circulation, i.e. ceding actual control over them, is also subject to a licence.

In addition, any import/export/transit of war weapons into/out of/through the territory of the Federal Republic of Germany is subject to a licence under section 3(1), (2) KrWaffG, as are the carriage of war weapons outside of German territory (*section 4 KrWaffG*) and the trade in war weapons outside of German territory (*section 4a KrWaffG*).

Under section 6(2), no. 2 KrWaffG granting of such licence *may* be refused, if, in particular, the applicant (in case of a legal entity applying for the licence: its body or member of its body) is not German or has its residence or place of customary abode outside Germany.

In addition, a licence will be *automatically* refused pursuant to section 6(3), no. 3 KrWaffG if the foreign applicant does not possess the requisite reliability to conduct the planned business. Persons who "*based on their character as manifested in their overall behaviour, provide no guarantee that the business will be duly and* properly conducted" are deemed unreliable[43].

23 - **Possibilities for revoking a licence in the event of acquisition by foreign investors.** - Under section 7(1) KrWaffG a licence may be revoked at any time.

Under section 7(2) KrWaffG a licence must be revoked if one of the grounds for refusal listed in section 6(3) KrWaffG subsequently becomes evident or comes about, unless the situation is redressed within a deadline to be determined. This may be the case, for instance, if, following the acquisition, the applicant no longer meets the reliability test within the meaning of section 6(3), no. 3 KrWaffG, i.e. if following the acquisition, certain decisions are made by the foreign investor which would be inconsistent with the objectives of the KrWaffG.

Revocation is the last resort, however. Exercising their discretion, the authorities must at least consider issuing a licence subject to substantive limitations, for a limited period of time, or with attached conditions. Based on the principle of proportionality, these are softer means, so a prohibition would be unlawful if equally suitable conditions would be a possibility.

Under section 9(1) KrWaffG the holder of a licence has to be granted reasonable compensation if it is revoked, but this does not apply if the licence is revoked on the grounds that a foreign applicant/licence holder does not/no longer meets the reliability test (section 9(2), no. 2, section 7(2), section 6(3), no. 3 KrWaffG).

42 *Epping, Lenz: Entschädigungsansprüche bei behördlicher Versagung, NVwZ 2005, 858.*

43 *Federal Administrative Court, decision of 2 nov. 1994, 1 B 215/93, headnote 1.*

C. - Premature termination of existing procurement contracts in case of acquisition of the contracting party by a foreign investor?

24 - Contracts entered into by the Federal Ministry of Defence, for example, with defence companies for the procurement of defence equipment usually do not contain a change-of-control clause to cover the eventuality of acquisition by a foreign investor. Given the far-reaching powers of intervention as regards the acquisition itself, but also as regards the company-specific licences (see above), a contractual provision of this kind is not actually really necessary.

It should be noted here, however, that any public subsidies the defence company may have received for research and development could be clawed back if a foreign investor takes control[44]. ■

44 Cf., for example, *section 16.3 of the "Auxiliary Terms and Conditions for Funds Provided by the Federal Ministry of Education and Research to Commercial Companies for Research and Development Projects on Cost Basis (NKBF 98)"*.

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