FREEDOM OF INVESTMENT, NATIONAL SECURITY AND "STRATEGIC" INDUSTRIES:

Tour d'Horizon of Recent Developments – Replies by Germany

December 17, 2008

This document is for consideration at Roundtable IX on "Freedom of Investment, National Security and 'Strategic' Industries" on December 17, 2008 [under item 3.a. of the draft agenda DAF/INV/A(2008)/4]. In it, Germany answers the questions posed to it in DAF/INV/WD(2008)16.

Kathryn Gordon, Telephone 331 45 24 98 42 Email: kathryn.gordon@oecd.org or April Tash, Telephone 331 45 24 90 93 Email: april.tash@oecd.org
GERMANY – DRAFT INVESTMENT LAW

As discussed at the eighth Roundtable, Germany’s cabinet has approved a draft amendment to the Foreign Trade and Payments Act and its implementing regulations, aiming to spell out the legal bases for government screening of new incoming investments. Currently still a draft, the proposal is available in German (online at http://www.bmw.de/BMWi/Navigation/Service/gesetzedid=223394.html).

At the eight Roundtable on 8 October 2008, Germany agreed to provide more complete answers to the questions posed by participants and in the Tour de table document. These questions are reproduced or further elaborated below.

Germany welcomes the opportunity to shed more light on its draft legislation. Before answering the questions in detail, Germany would like to point out that the German investment regime has traditionally been very liberal. For decades there was no examination in any form of foreign investments. It was not until 2004 that a review of acquisitions of 25% or more of the voting shares of German enterprises producing certain military goods and cryptographic equipment for intergovernmental communication by foreign investors was introduced. In December 2007, this review was updated to include the acquisition of 25% or more of the voting shares of certain earth observation systems. No investments have been prohibited under these acts until today. Germany has a fundamental interest in maintaining an open investment climate throughout the world, as underscored in the G8 Heiligendamm Summit Declaration of June 8, 2007. Germany will continue its active efforts to effectively reduce investment barriers worldwide. However, in line with the OECD-standards, Germany believes that government must balance the principle of openness with the responsibility to ensure public order or security for its country. To attain this balance, Germany acknowledges that governments must have the possibility to examine relevant investments for possible risks to public order or security. Accordingly, the new legislation will extend the scope of examination of foreign investments, but only allow an investment to be prohibited if it constitutes a genuine and sufficiently serious threat to public order or security.

Questions:

- Could Germany offer as much detail as possible about the decision processes that the draft law would set up? In particular, how would it seek to ensure non-discrimination, transparency, proportionality and accountability in the operation of its proposed investment review mechanism as recommended in accordance with the recently-developed Freedom of Investment project’s guidelines for recipient country investment policies relating to national security?

**Decision process:** The draft law provides for lean procedures: The draft act does not establish a requirement of authorisation or registration. The Federal Ministry of Economics and Technology
may decide to initiate a review of the investment within three months of the signature of the purchase contract or the publication of the decision to make a public offer or of the fact that control of the company has been attained. In case of a review the purchaser must submit all required information concerning the acquisition. The Ministry of Economics and Technology may subject the acquisition to certain conditions or order a prohibition within two months of receipt of the information. If the Ministry does not take any action within this period of time, the acquisition may not be examined thereafter. In order to attain legal certainty promptly, the investor may apply for a certificate of non-objection from the Ministry of Economics and Technology before signing a contract. This certificate confirms that the investment does not endanger public order or security and binds the Ministry, i.e. once the Ministry has issued the certificate it cannot initiate a review.

**Non-discrimination:** please see question 3 a).

**Transparency/Accountability:** All requirements established by the draft law – e.g. the list of documents to be submitted – are publicly available. Any decision of the Ministry of Economics and Technology to submit an acquisition subject to restriction or prohibition has to be substantiated towards the investor and may be challenged in the Administrative Courts. Moreover, the basis for appeals may include the Ministry’s decision to initiate a review. Finally, the European Commission may initiate infringement procedures if it suspects a violation of Germany’s obligations under the European treaty.

**Proportionality:** The draft law is in line with the OECD principles that the freedom of investment should not be challenged and safeguards to protect public security and order should be limited: The draft law provides for a threshold of 25% of the acquisition of the voting shares. Any acquisition of a smaller percentage of the voting shares is not subject to any review. Thus a large number of investments – especially the investments of Sovereign Wealth Funds – are not covered. If an investment is subject to an examination, it may only be restricted or prohibited if it threatens Germany’s public order or security. A genuine and sufficiently serious threat affecting one of the fundamental interests of society must exist. The draft legislation refers explicitly to the EC Treaty and the case law of the European Court of Justice (ECJ). The standards established by the ECJ can be met in exceptional cases only.

- The draft law proposes a mechanism that screens certain investments which may threaten “public order” and “public security.” The draft law requires that these terms be interpreted and applied in a manner consistent with the EC Treaty and European Court of Justice jurisprudence.
  - Is the term “public security” to be analogous with “national security?” Can Germany explain what is meant by the term?
  - Could you clarify the meaning of “public order”? Would it include concepts like “economic security” or “industrial policy”?
The terms “public security” stems from Art. 58 of the EC-Treaty.

In its jurisdiction, the ECJ does not distinguish clearly between public policy and public security, but quotes these legal terms consistently. “Public policy and security” may, according to the ECJs jurisdiction and the draft law, be relied on only if there is a genuine and sufficiently serious threat to a fundamental interest of society. The ECJ’s jurisdiction excludes economic security or industrial policy, see e.g. C-54/99, Scientology Church (para. 17).

What are the reasons for not limiting its review process only to national security/public security considerations and for including broader considerations implied by “public order”?

The inclusion of both public order and public security stems from the requirements established by EC-law, see Art. 58 of the EC-Treaty. A limited reference to “public security” might be misunderstood as a reference to Art. 296 of the EC-Treaty. It should also be noted that the ECJ does not formally distinguish between public policy and security but uses both terms under one definition (see question above).

Moreover, Art. 3 a) of the OECD Code refers to public order. Therefore, a limited reference to national security interests would also exclude aspects covered by the Code.

- The screening mechanism in the draft law applies to non-EEA companies, but not to EEA companies. Companies whose shares owned by non-EEA nationals represented more than 25 per cent of their voting stocks are defined as non-EEA companies, if these companies are incorporated under an EEA country's laws, including laws conforming with EU directives.

- The first general principle of the Freedom of Investment project's guidelines for recipient country investment policies relating to national security is that "governments should be guided by the principle of non-discrimination. In general governments should rely on measures of general application which treat similarly situated investors in a similar fashion. Where such measures are deemed inadequate to protect national security, specific measures taken with respect to individual investments should be based on the specific circumstances of the individual investment which pose a risk to national security". How does Germany reconcile its discrimination between EU and non-EU investors on the basis of their nationality with this principle? In what a non-EU controlled company incorporated under EU law similarly is not a "similarly situated investor" relative to an EU-controlled investor in regard to public order consideration for instance? Under which EC Treaty provisions does Germany justify the possibility of discriminating between EU and non-EU investors?

The EC-Treaty distinguishes between EU- and non-EU-members: Art. 56, which establishes the freedom of movement of capital, applies to both member-states and third countries. However, the jurisdiction of the ECJ on Art. 58 of the EC-Treaty, which allows for measures on the ground of public policy or security, clearly allows for distinctions between member states and third countries and subjects measures against investors of member states to a much stricter standard. Moreover, Art. 43, which protects the freedom of establishment, is limited to member states. The rationale for the distinction between EU-members and third countries of the EC-Treaty and the ECJs jurisdiction is that circumstances between EU-members and non-EU-members are not
alike: The EU has a common market and a common legal framework and member states have vested a number of sovereign powers on the EU. Comparable prerequisites do not exist between the EU and third countries. Therefore, the draft law provides for a limited review of EU-based companies which are controlled by non-EU-owners: an examination is possible if there are indications that the EU-company is used as a vehicle to circumvent a possible examination (see the explanatory memorandum of the draft law). According to the ECJ’s jurisdiction, this applies typically e.g. for shell corporations which do not meet alike circumstances as companies which follow regular business activities within the EU.

− Article 58 of the EC Treaty permits EU Member States to take measures which “are justified on grounds of public policy or public security.” Does Article 58 provide the legal basis for screening non-EU companies? If so, and if the draft law’s aim is generally to protect “public order and public security,” why wouldn’t Article 58 provide the same grounds for screening EU companies as well?

See answer to question above. According to German constitutional law, Germany cannot examine investments for possible threats to public order or security pursuant to Art. 58 EC Treaty without a legal basis under German law.

• How will the review procedure generate information on investments which may warrant review? Will the investor have guidelines as to whether it should file the proposed transaction with the Ministry of Economics? On the basis of which information will the Ministry decide to start an investigation?

Since the review will be initiated ex officio, it is the sole responsibility of the Ministry of Economics and Technology to monitor the market for investments which might fall under the scope of the law. Given the fact that a review is conceivable under rare circumstances only, the Ministry is confident that the intended investment will meet enough public attention to alert the Ministry in due time. Moreover, the Ministry will receive information of the federal agency on banking supervision and the federal cartel office on a confidential basis which these institutions receive in the course of their work. Since the investor does not have to file an investment, no guidelines are necessary. Only if the Ministry initiates a review, the investor is obliged to submit information. The list of documents required for the review will be published in the Federal Gazette before the entry into force of the amendment.
Economist Intelligence Unit -- Country Report on Germany, October 9, 2008 Thursday

Economic policy: Volkswagen law remains contentious with EU

On September 19th the Bundesrat (the upper house of parliament) passed an amendment to the controversial "Volkswagen" law following an earlier decision by the European Court of Justice (ECJ), which had found it to be in contravention of EU law. The government had initiated the move in early 2008 in response to a 2007 ECJ ruling which found, among other things, that the Volkswagen law was discriminatory against non-German investors, thus hindering free capital mobility in the EU. However, as the amendments passed in September do not address this issue, the European Commission has indicated that it plans bring a further case to the ECJ. Meanwhile Porsche, which wants to take over Volkswagen, increased its share to 35% in September and supports the position of the European Commission.

Questions:

- The article states that the “Volkswagen law”, following the finding of the European Court of Justice that the law is in contravention of EU law, has been amended. It also suggests that the amendments to not address the issue of discrimination against foreigners.

- Can Germany provide further information about the application and status of this law?

A law to change the “Volkswagen law” was passed by the Bundestag on 13 November 2008 and by the Bundesrat on 28 November 2008. It is going to be in effect after the announcement in the Federal Gazette presumably before the end of 2008.

The law was made in response to the ECJ ruling of 23 October 2007, which states: “A Member State which maintains in force legislation which, in derogation from ordinary company law, combines a limitation of the voting rights of every shareholder in a given company to 20% of that company’s share capital with the requirement of a majority of over 80% of the company’s capital for the adoption of certain decisions by the general assembly, and which, in derogation from the general law, allows a Member State and a territorial entity of that State each to appoint two representatives to the company’s supervisory board, fails to fulfil its obligations under Article 56(1) EC.”

The revised “Volkswagen law” eliminates the limitation of voting rights to 20% and of the right to appoint two representatives to the company’s supervisory board. In the opinion of the German government these two modifications fulfil the obligations set by the ECJ. However, since the European Commission has indicated that it is not satisfied with the current implementation of the ECJ ruling, the German government is examining the arguments of the Commission in order to decide on further actions. The Commission has set a deadline for an answer of the German government in this issue until the end of January 2009.

- Over what time period does Germany plan to eliminate the discriminatory treatment against foreigners?
The German government is not of the opinion that the changed “Volkswagen law” includes any discriminatory treatment against foreigners. However, as aforementioned, the German government is in the state of further evaluation of the ECJ ruling and will come up with a final decision on further actions by the end of January 2009.

- The “Volkswagen law” does not appear in any of Germany’s reservations or notifications under the OECD investment instruments. What is Germany’s view about the appropriate treatment of this law under the instruments?