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Rethinking production capacities: Your path into the security and defence industry – with legally sound support



Economic opportunities through market entry

The automotive industry in Germany is facing its biggest crisis in decades. This crisis is not only affecting car manufacturers, but also suppliers throughout the entire supply chain.

At the same time, the security and defence industry in Germany and Europe is currently experiencing a tremendous influx of capital. For many affected companies, entering this dynamic sector may therefore offer an opportunity to put existing, currently unused capacity to profitable use.

Entering the security and defence industry, whilst potentially economically attractive, presents significant – albeit not insurmountable – legal challenges. We would like to provide you with an overview of these challenges and our advisory services, through which we can support you in this strategic decision.

Project planning and corporate structure

It is generally advisable to establish a separate business unit for the production and distribution of goods for the defence industry. To this end, you could, for example, carry out a spin-off or demerger from an existing company and, in the process, transfer production capacities to the new business unit. Often, specific production know-how is required that is not yet available within your company. In such cases, you should also consider operating the business unit as a joint venture with a company already familiar with the requirements of the security and defence industry.

This raises various issues under company law. To ensure that the corporate relationships are properly regulated, it is strongly recommended that the agreements concluded between the shareholders be carefully drafted. To safeguard your legal position, it may be necessary to carry out due diligence.

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Furthermore, competition law requirements must be taken into account. In particular, participation in joint ventures involving large systems integrators should first be reviewed for compliance with competition law.

Luther possesses extensive expertise in competition law matters and is on hand to assist you with the corporate structuring of your new business unit.

Tax law aspects

When organising the business unit – particularly when choosing its legal form – tax aspects are naturally also relevant, as the taxation of partnerships (in particular limited partnerships) is subject to different rules than the taxation of companies (in particular GmbHs and AGs). As a full-service law firm, we have been advising on tax law for many years and can support our clients in developing the most favourable tax solution.

Financing and ESG

Entering the security and defence industry is typically capital-intensive. In addition to transaction and organisational costs, there are costs associated with retrofitting production facilities. For suppliers to the automotive industry considering entering this sector, options for (external) financing are therefore particularly relevant.

In the context of financing, the question repeatedly arises as to whether investments in the security and defence industry are sustainable in terms of ESG compliance. This is significant because it is a requirement for potential investments by certain funds. Ultimately, this question remains unresolved; however, there is a growing consensus that investments in the security and defence industry can, at least under certain circumstances, be regarded as sustainable. The European Commission has also recently published a statement on this matter.

Furthermore, where investments involve foreign investors, the requirements of investment control legislation must regularly be observed, as the Federal Ministry for Economic Affairs may, under certain circumstances, prohibit such investments.

It should also be noted that, pursuant to Section 60(1) of the Foreign Investment Act (AWV), investments in the security and defence sector by foreign nationals who are citizens of EU Member States also fall within the scope of investment control legislation and may therefore be prohibited by the Federal Ministry for Economic Affairs. Consequently, the provisions of investment control legislation should be examined in the case of any foreign participation.

Luther supports you in identifying the optimal financing options for your business. We have extensive experience in all phases of financing.

Preparatory measures: product development and supplier integration

A successful entry into the security and defence industry requires the company in question to decide what (and for whom) it should produce. To this end, it is necessary to determine which products your customers require. One option is to contact companies in the security and defence industry to be included in their supplier pool. In addition, the contract advisory services of the Chambers of Industry and Commerce in the federal states offer to refer suppliers to defence companies on request.

In the security and defence industry, the requirements that a manufacturing company must meet depend to a large extent on which product is to be produced and at which stage of the value chain.

Specific technical requirements for the product and its manufacture, particularly the necessary certifications, may arise from a variety of DIN standards (e.g. DIN EN 9100 or DIN 2303), ISO standards and, in some cases, specific

standards set by the armed forces, such as the Bundeswehr's Defence Technical Requirements or Technical Delivery Conditions.

NATO has set out its technical requirements for products in the so-called Allied Quality Assurance Publications (AQAP), some of which correspond to DIN and EN standards. The Bundeswehr often bases its requirements on these NATO specifications and then makes them a binding contractual requirement for the product.

However, the standards mentioned do not replace the requirements for the product arising from the supply contract. The content of the contract is therefore of crucial importance for the supplier relationship. Through negotiation and the drafting of contracts, you can generally influence the technical requirements your product must meet. Our experts in commercial and distribution law can provide you with comprehensive support in this regard. Should statutory requirements nevertheless apply to your products, our specialists in commercial and distribution law and product compliance possess the necessary expertise to minimise liability risks as effectively as possible.

Confidentiality and Classified Information

Depending on the specific nature of your contractual relationship with your customers, you may come into contact with classified information and be required to ensure the necessary protection of trade secrets. We will work with you to develop the legally required solutions.

We therefore assist you in meeting the requirements of the Security Clearance Act. If employees or directors of your company come into contact with classified information as a result of entering the security and defence sector, a security clearance must be obtained for the relevant employees in accordance with the Security Clearance Act. There are very few exceptions to this obligation.

Our colleagues in the IP/IT and Commercial and Distribution Law departments can advise you on matters relating to the protection of classified information.



Employment law briefing for your entry into the defence sector

Your entry into the security and defence industry brings with it new employment law challenges. Luther supports you with many years of defence-specific employment law expertise – pragmatic, tailored and from a single source. The principle applies: no production without logistics – in the security and defence industry, this means that the highest level of security in production also requires uncompromising security in logistics, particularly when using external third-party staff. Whether you are a company in the supply or logistics sector, we advise you on setting up a new business unit or adapting an existing one within the security and defence industry on all employment law matters – from potential transfers of undertakings involving mandatory staff transfers to the specific requirements for new hires subject to security vetting. We work with you to define tailor-made security requirements for employees (e.g. criminal record checks, background checks), develop tiered security concepts depending on proximity to the end product, and establish processes for the ongoing review, documentation and enforcement of these requirements, ensuring that your HR compliance remains legally sound and practical even within the highly sensitive defence sector. Furthermore, we ensure that collective labour law – and in particular the co-determination rights of your works council – are integrated in a practical manner from the outset, for example in the event of operational changes, so that your entry into and work within the defence sector proceed smoothly and with minimal conflict.

When working hand in hand with your defence client, setting the right contractual course with the client is also crucial. Whether it is a service contract or a temporary agency work arrangement: we will design a legally sound yet efficient employment law solution for you that takes into account the specific security requirements for your workforce.

Supply Chain, Quality Management and Contract Drafting

In practice, effective supply chain management often requires the establishment of a quality management plan. You should therefore definitely consider putting such a plan in place. This is necessary, if only to ensure that your products meet the contractual requirements, as your client may themselves bind you to a quality management plan through contractual provisions. If the procurement is based on a NATO contract, such a quality management plan is even mandatory. The Federal Association of the German Security and Defence Industry has provided a number of ‘golden rules’ which can serve as a guide when drafting contracts. We would, of course, be happy to assist you with the practical details of implementation.

A second area where it is important to avoid potential risks is the drafting of your contracts – both with your customers and your suppliers. As experienced advisers in commercial and distribution law, industrial construction, and the field of public procurement and its contractual frameworks, we possess the expertise to avoid pitfalls and navigate the treacherous waters. We identify ‘red flags’ in draft contracts, work with you to draw up tailor-made counter-proposals and support you in negotiations with your contractual partners. Legal assistance in these matters is strongly recommended, as the economic consequences of unfavourable provisions can be immense. Because security of supply is of enormous importance in the security and defence sectors, the German Armed Forces frequently require supply obligations for spare parts lasting 20 years or more. It is therefore essential to negotiate and agree on appropriate consideration in return for this long-term contractual supply obligation. It is also important to be familiar with the relevant Bundeswehr contract terms, as these may also become part of your obligations via subcontractor or supply chains.

Export controls: weapons of war, dual-use goods and catch-all provisions

Depending on the specific nature of your project, you may find yourself subject to the provisions of the Weapons Control Act or the legislation governing the export of weapons and dual-use goods.

In such cases, too, we possess the necessary expertise to overcome any legal hurdles.

Car manufacturers wishing to produce certain military vehicles, for example, must be prepared to comply with the provisions of the War Weapons Control Act. Other legislation that may be relevant in specific cases includes the so-called Dual-Use Regulation for certain civilian goods with potential military applications and the Foreign Trade and Payments Regulation, which is particularly relevant for certain exports.

Public Procurement Law

An area of law that plays no role in the automotive industry, but is virtually indispensable in the security and defence sectors: public procurement law. If you operate as a supplier or even as a direct contractor in the defence sector, you will need to take public procurement requirements into account. Those who are well-prepared in this area have better economic opportunities. This is because errors in the procurement process could potentially cost you the contract.

With our many years of expertise in public procurement law, covering both public contracting authorities and bidders, we guide you through the procedures in a targeted and pragmatic manner. We provide training to ensure your procurement team is prepared for the requirements and support you throughout the tendering process.

In a nutshell

We provide comprehensive advice on all relevant legal issues in the security and defence industry – from corporate law planning and tax structuring to financing, product-related compliance, implementation under employment law and contract drafting.

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