

Newsletter

Control of Foreign Investments in Germany

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Control of Foreign Investments: Tightening of German Regime

The German Federal Government and the German Federal Parliament recently adopted comprehensive amendments to both the German Foreign Trade and Payments Act (hereinafter referred to as "AWG") and its implementation regulation, the Foreign Trade and Payments Ordinance (hereinafter referred to as "AWV"). The changes lead to a significant tightening of the German investment control regime. Legislative measures had become necessary in order to implement the EU Regulation on the Screening of Foreign Direct Investments 2019 (hereinafter referred to as "EU FDI Screening Regulation") into national law. Additional amendments can be seen as a reaction to the Covid-19 crisis.

In the following, we provide a brief overview of the German rules on foreign investment control and highlight the key changes resulting from the most recent reform.

German foreign investment examination

According to AWG and AWV, the Federal Ministry for Economic Affairs and Energy (hereinafter referred to as "BMWi") is entitled to examine foreign investments in German companies – whether direct or indirect – and, in exceptional cases, prohibit any such investment, or grant permission subject to certain conditions after an in-depth examination.

The law provides for two types of investment examinations, a cross-sectoral review and a sector-specific review.

Cross-sectoral review

Acquisitions of 10 % or more of the voting rights by a non-EU or non-EFTA based investor are subject to a cross-sectoral review if the target company belongs to one of the sectors as specified by AWV, namely if it operates critical infrastructure such as energy, water, IT and telecommunications or develops and modifies software for those operations. In these cases, the parties are obliged to notify the BMWi.

In addition, even if the target company does not belong to one of those sectors, a cross-sectoral review can be applied to any acquisition of a German company or shares in a German company, irrespective of its size or the sector the company operates in, if a non-EU or non-EFTA based investor – directly or indirectly – acquires 25 % or more of the voting rights in the company. In these cases, however, the parties are not obliged to notify the BMWi but the BMWi may start proceedings ex officio. Therefore, it is possible that an investor can request a binding certificate of non-objection from the BMWi prior to the planned acquisition in order to obtain legal certainty as to whether the transaction raises public concerns.

Sector-specific review

Whereas the cross-sectoral review applies only to non-EU and non-EFTA based investors, the sector-specific review applies to all foreign investors from outside Germany. Any acquisition of a company must be notified, if an investor from outside Germany acquires 10 % or more of the voting rights in a company that operates in a sensitive security area. Companies operating in a sensitive security area include manufacturers and developers of war weapons, ammunition and other military technologies or equipment. The BMWi reviews in-depth whether the transaction leads to a probable impairment of essential security interests of Germany.

Most important amendments to the AWG

The revised AWG aligns Germany's investment examination rules to the EU FDI Screening Regulation, which establishes a framework to proactively protect the security interests of each single Member State, but also of the European Union as a whole, and which strengthens the cooperation within the European Union.

In principle, the new law implements the following changes:

- **Lower threshold for BMWi to intervene**

Up to now, the BMWi was only entitled to intervene in a foreign investment if it came to the conclusion that the reviewed transaction causes actual and sufficiently severe danger to Germany's public order or security. Under the new law, the substantive test to be applied by the BMWi is whether, as a result of the acquisition, public order or security is likely to be impaired.

- **Extension of the scope of the substantive test**

In addition, the scope of the substantive test to be applied by the BMWi is extended. From now on, the BMWi will assess not only whether the acquisition is likely to impair the public order or security in Germany, but also in any other Member State of the European Union or in relation to projects or programs of interest to the European Union.

- **Extension of provisional invalidity to all transactions subject to reporting requirements**

Previously, the implementation of transactions underlying the cross-sectoral review was valid, irrespective of whether the BMWi had to be notified and proceedings were opened by the BMWi. Thus, it was possible that the acquirer completed an acquisition before the end of the examination procedure. This has been changed as a result of the reform: the implementation of transactions that are subject to a reporting requirement – both sector-specific and cross-sectoral – is provisionally invalid until approval is obtained. In addition, criminal consequences for certain failures to comply with the applicable rules are introduced in order to ensure the effective enforcement of the prohibition.

- **Establishment of a national contact point**

In future proceedings, the EU Commission and other Member States will play a more vital role. In particular, they will be informed and will have the right to comment. The BMWi shall act as a link between national and European institutions in order to ensure the exchange of information throughout the European Union.

Important amendments to the AWV

- **Extension of the list of security relevant companies**

The AWV stipulates which companies are especially relevant for public order or security and therefore an acquisition of 10 % or more of the voting rights in such companies triggers reporting requirements under the rules on cross-sectoral reviews (and a standstill obligation, see above). Provoked by the outbreak of Covid-19, the list of security relevant companies was extended to companies that develop, manufacture or distribute essential medical products (such as personal protective equipment as well as phar-

maceuticals and other products related to "life-threatening and highly contagious infectious diseases"), but also to companies that provide services required to ensure the freedom from interference and functionality of state communication infrastructure.

● **Extension of reviewed transaction structure**

It is clarified by the amendment that not only share deals are subject to the investment examination, but also asset deals. This clarification applies to cross-sectoral as well as sector-specific reviews.

● **Investor background checks**

Furthermore, the amendment explicitly states that the background of the investor shall be taken into account for the substantive test whether to intervene or not. According to the amendment the following criteria shall be considered:

- the acquirer is directly or indirectly controlled by a foreign government, including governmental agencies or armed forces;
- the acquirer has already been involved in activities which have had a detrimental impact on public order or security of Germany or another Member State of the European Union; or
- a significant risk exists that the acquirer or the persons acting on his behalf were or are involved in activities which constitute a crime (such as money laundering, fraud, bribery or corruption) or an administrative offense under AWG or the law on the control of war weapons.

What effects will the new rules have?

The amendments to AWG and AWV undoubtedly raise additional obstacles to the acquisition of German companies by non-EU investors. More transactions will have to be reported, more transactions will be subject to a standstill obligation, and more interventions will be possible due to a broadened substantive test. However, it remains to be seen if and to what extent the BMWi will make use of its new powers in this area that is also of highly political relevance.

And what comes next?

On national and EU level, the next tightening of rules on foreign investment is already underway. On 17 June 2020, the EU Commission published its "White Paper on levelling the playing field as regards foreign subsidies". This document proposes various measures to address subsidies granted by countries from outside the EU that may distort competition within the EU. In particular, the EU Commission suggests that transactions supported by foreign subsidies should be made subject to a prior notification obligation and a corresponding standstill period until the EU Commission has decided whether to prohibit the transaction or not. With the White Paper, the EU Commission invited the public to comment on the proposals by 23 September 2020. Given the current political atmosphere in the context of the Covid-19 crisis in the EU, it seems likely that rules of this kind will be adopted.