

ALLEN & OVERY

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Foreign Direct Investment Screening in Germany – most recent developments

What foreign investors need to consider

Speedread

Germany is one of the few countries in the world where the doors are wide open to foreign investment. With an export-oriented national economy, Germany thrives where markets are open for cross-border trade and investment. Germany's trading partners benefit as well: cross-border trade and investment is not a one-way street.

Most recently, Germany introduced changes to its rules on the screening of Foreign Direct Investment (**FDI**). Some of the changes had been planned long before the Covid-19 virus came to Germany, others were introduced in the face of the crisis. Most importantly:

- Transactions concerning critical infrastructure are now subject to a suspensory effect, i.e. they cannot be completed without approval of the Ministry of Economic Affairs and Energy (the **Ministry**);
- Further business activities, particularly in the healthcare sector, were defined to form part of Germany's critical infrastructure, including producers of personal protective equipment, essential therapeutics, in vitro diagnostics in the field of infectious diseases and medical devices for infectious diseases; moreover, businesses delivering services necessary to ensure the proper functioning of governmental communication infrastructure of the Federal Agency for Digital Radio Safety were qualified as critical infrastructure;
- Sharing information prior to clearance ("gun jumping") has been made a criminal offence; and
- In determining whether a foreign direct investment is likely to affect security or public order, the amendments clarify that the Ministry may take into account whether the purchaser is directly or indirectly controlled by the government, including state bodies or armed forces, of a third country, including through ownership structure or significant funding.

Germany is not alone with the tightening of its rules on FDI screening: the corona pandemic left its mark on FDI screening in many jurisdictions around the world.

For investors, the multi-jurisdictional analysis of FDI screening rules and requirements is of strategic importance. Sellers seek transaction certainty and expect that investors will be able to discuss issues and challenges on an informed basis.

For the success of future transactions, it is crucial to recognise and take into account developments in the FDI space at an early stage. A&O is monitoring the current developments in detail. We have been advising on FDI screening for many years. Operating with global reach and local depth, we are happy to use our broad wealth of experience and our close working relationship with responsible decision-makers in the interests of our clients.

Introduction

Over the last few years, a number of countries changed their rules on foreign direct investment screening, giving governments more space to block deals or impose conditions on their completion – a trend that has been primarily based on national security concerns. However, a number of countries have now implemented, or plan to implement, further reforms, using control over foreign investment as a means to protect wider economic and social concerns triggered by COVID-19. Also, the European Commission singled out the issue of FDI screening as to protect critical European assets and technology. Most recently, on 17 June 2020, the European Commission published a White Paper dealing with the distortive effects of foreign subsidies on the acquisition of EU companies. These developments highlight the need for investors to carefully consider and take a strategic approach with regard to foreign investment review risks in respect of their contemplated transactions.

Germany is a country where substantial parts of the economy depend on exports and free markets and where foreign investment has always been welcome. Government intervention is permissible only for reasons of public order or safety. Since 1949, the government has blocked only two transactions: The acquisition of the German company *Leifeld* by a Chinese investor in August 2018 and a transaction in the defence sector in 2019. Since the acquisition of the iconic robotics company *Kuka* in 2016 at the latest, Germany has enlarged its ammunition box to deal with foreign investment. In January 2020 – quite some time before COVID-19 started spreading in Germany – the Ministry of Economic Affairs and Energy presented draft legislation designed to further tighten its grip on non-European investors. This proposal passed the German Federal Government on 8 April 2020 and was adopted by Parliament on 18 June 2020; it will take effect within the next few days. Beyond that, the Ministry published a first draft of the 15th Amendment to the German Foreign Trade and Payment Act, which was approved by the German Federal Government on 20 May 2020 and took effect on 3 June 2020.

The substance of the changes, and the speed of implementation, underpin that the German government is willing and able to adapt to new situations in the current environment fast and decisively. Non-European investors interested in acquiring businesses in Germany should be acutely aware of the changes and carefully consider the impact on their contemplated transactions.

Key elements of the legal framework

The German rulebook on the screening of foreign investment distinguishes between three different categories of investments:

- The first category comprises certain businesses in the military industry and in the field of encryption technologies. In this category, any direct or indirect acquisition of 10% or more of the voting rights by a non-*German* investor must be notified to the Federal Ministry of Economics and Energy. The rules provide for a suspensive effect, i.e. the transaction can be consummated only after it has been approved by the Ministry.

- The second category comprises businesses operating in, and supplying, critical infrastructure. The direct or indirect acquisition of 10% or more of the voting rights in these businesses by a non-*European* investor must be notified to the Ministry. Investors from EFTA Member States enjoy the same treatment as investors from other EU Member States. The same is the case with UK investors, but only until 31 December 2020 (assuming that the Brexit transition period will then expire). So far, the rules have not provided for a suspensive effect, i.e. it was possible to consummate transactions without waiting for Ministry approval (albeit at the risk that the Ministry may impose restrictions post-closing). With the legislation adopted on 18 June 2020, this has changed.
- The third category comprises all other German businesses by non-*European* investors. In this category, a filing with the Ministry is voluntary. However, if the investor directly or indirectly acquires 25 % or more of the voting rights in such a business and decides against a voluntary filing, the Ministry can initiate an examination of the acquisition within the shorter of three months after becoming aware of the transaction and five years after signing. For the transaction parties, this is not a comfortable position to be in: according to statutory law, the acquisition agreement will be null and void if the Ministry prohibits the transaction. To obtain legal certainty, the investor may apply for a certificate of non-objection (*Unbedenklichkeitsbescheinigung*) and consummate the transaction after such certificate has been issued.

Amendments to the Foreign Trade Act

On 18 June 2020, the German Parliament adopted the following amendments to the FDI Screening rules:

- The right of the Ministry to intervene and to open a review procedure does no longer require an actual threat of the German public order or security; a probable impairment is sufficient. The government is convinced that this will enable a more comprehensive and forward-looking foreign investment review.
- The Ministry is entitled to consider not only interests of the Federal Republic Germany but also interests of other EU Member States and the EU as such. This proposal is designed to implement EU Screening Regulation 2019/452 which will allow for EU-wide coordination of FDI screening procedures as from 11 October 2020.
- Transactions in the field of critical infrastructure are subject to the suspensory effect. This means that the acquisition of a German business by a non-European investor cannot be consummated without clearance from the Ministry.
- There is ban on sharing information prior to FDI clearance (“gun jumping”). Breaches constitute a criminal offense (sanctioned by prison of up to five years).

Amendments to the Foreign Trade Regulation

On 3 June 2020, the following amendments to the FDI Screening rules took effect:

- Certain business activities in the healthcare sector were defined to form part of Germany’s critical infrastructure. They include producers of:
 - personal protective equipment (including preliminary products and components),
 - essential drugs (including starting materials and active ingredients),
 - in vitro diagnostics in the field of infectious diseases (including precursors and components), and
 - medical devices for infectious diseases (including preliminary products and components).

- In the technology sector, business delivering services necessary to ensure the proper functioning of governmental communication. Infrastructure of the Federal Agency for Digital Radio Safety were defined to be critical infrastructure.
- It has been clarified that asset deals are in scope of the FDI screening regime. This means that the acquisition of (i) a part of the business of a German company and (ii) all or part of the essential operating resources of a German company will constitute an acquisition for purposes of the FDI screening regime.
- The Regulation now includes express language according to which the review may take into account whether an acquirer is directly or indirectly controlled by the government, governmental agencies or armed forces of the relevant third country. It may also consider how such control over the acquirer may be exercised over and above a negligible level, based on the ownership structure, in the form of financial resources or otherwise. The materials explain that this is a clarification, not a new rule.

Outlook

Germany is one of the few countries in the world where the doors are wide open to foreign investment. With an export-oriented national economy, Germany thrives where markets are open for cross-border trade and investment. Germany's trading partners benefit as well: cross-border trade and investment is not a one-way street.

With the legislative changes, Germany stocks up its toolbox to address situations where a transaction is considered by the Ministry to constitute a threat to public order and safety in Germany. But none of the new tools presents a dramatic change: Whether a certain investment presents an actual threat or a probable impairment of the German public order or security has never been an issue in the cases which we had represented. Likewise, the suspensory effect for critical infrastructure investments will not change transaction practice as prudent investors have regularly made FDI clearance a closing condition when investing in critical infrastructure. Similarly, the new sanctions on "gun jumping" should not bite investors that play by the rules and implement their post-merger integration only after all approvals have been obtained and closing has happened.

Even the new language according to which the review may take into account whether an acquirer is directly or indirectly controlled by the government, governmental agencies or armed forces is not really a novelty. The Ministry did have the power to include these factors in its assessment even before the Regulation took effect. As shown by the White Paper of the European Commission dated 17 June 2020, the distortion of competition by government funding is a wider issue. It is not only a challenge in FDI screening proceedings for sovereign wealth funds or investors from countries where business and government are closely intertwined. It is a challenge also for businesses that enjoy subsidies from their governments at home whilst its European counterparts have to live without government funding. Developments in this area should be carefully monitored.

This being said, given the past track record of FDI clearances, there is no reason to believe that, from now on, the Ministry will massively block foreign direct investment. To the contrary, in our experience the Ministry often tried to tackle challenges to public order or safety with contractual arrangements, thereby reconciling the public interest in order and safety with the interests of investor and seller to consummate the proposed transaction.

This notwithstanding, investors need to have a strategy on how to approach the Ministry. Certain cases may solely require a filing at working group level. Other cases may require an approach at the top. Key messages must be carefully phrased. Investors need to have a crystal clear awareness of the strengths and weaknesses of their case, current trends in the Ministry's administrative practice and in the flow of public opinion.

As mentioned above, Germany is not alone with the tightening of its rules on FDI screening: the corona pandemic left its mark on FDI screening in many jurisdictions around the world.

With FDI screening getting tighter around the world, the multi-jurisdictional analysis of FDI screening rules and requirements is of strategic importance for investors. This is the case even more after 11 October 2020, the day on which EU Regulation 2019/452 will take effect. This regulation does not provide for a one-stop EU FDI clearance but implements a legal framework for the coordination of FDI screening procedures that each of the EU Member States may be conducting in accordance with their domestic laws. Sellers seek transaction certainty and expect that investors will be able to discuss issues and challenges of FDI screening on an informed basis.

For the success of future transactions, it is crucial to recognise and take into account developments in the FDI space at an early stage. A&O is monitoring the current developments in detail. We have been advising on FDI screening for many years. Operating with global reach and local depth, we are happy to use our broad wealth of experience and our close working relationship with responsible decision-makers in the interests of our clients.

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For further information on Foreign Direct Investment in Germany please also see the links below:

[Covid-19 coronavirus update: Global application of foreign investment control rules](#)

[Update on Foreign Direct Investment Screening: Health care sector becomes part of critical infrastructure](#)

[Covid-19 pandemic: Foreign Direct Investment Screening: Germany tightens the rules in light of the Covid-19 pandemic](#)

[White Paper: European Commission targets foreign subsidies causing market distortions](#)

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