

THE GERMAN FDI REGIME: MAIN FEATURES AND PRACTICAL EXPERIENCE

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Foreign investment control in Germany is governed by the Foreign Trade and Payments Act (*Außenwirtschaftsgesetz*, "AWG") and the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung*, "AWV"), with the AWG setting out the legal framework and general principles, and the AWV specifying the details of the relevant sectors as well as the procedure.

During the course of 2020, the AWG and AWV have been significantly amended following the adoption of the European Union's Foreign Direct Investment ("FDI") Screening Regulation in March 2019. The AWV under-

went another substantial reform in May 2021, which significantly increased the number of sectors subject to screening.

Apart from the FDI Screening Regulation, two cases that were covered broadly by German media may have accelerated these reforms. In 2018, a state-controlled Chinese company attempted to acquire 50Hertz, an electricity grid operator. And in March 2020, at the start of the COVID-19 pandemic, the then US-President Donald Trump is reported to have suggested the acquisition of "CureVac," a German biopharmaceutical company specializing in vaccine development.

The new rules significantly expand the scope of FDI control in Germany and strengthen the powers of the competent authority, the Federal Ministry for Economic Affairs and Climate Action (*Bundesministerium für Wirtschaft und Klimaschutz*, "BMWK"). In essence, the regime is now both broader and stricter.

TYPES OF TRANSACTIONS SUBJECT TO GERMAN FOREIGN INVESTMENT CONTROL

Sector-specific assessment

The "sector-specific assessment" applies to acquisitions by non-German investors (including EU investors) who acquire at least 10% of the voting rights in a German company operating in one of the sectors considered particularly sensitive. These include, inter alia, the manufacture of weapons, military equipment and encryption technology. The transaction parties must notify the BMWK of the transaction, and the closing is subject to the BMWK's approval. In the review process, the BMWK assesses whether the foreign investment "*is likely to impair essential security interests*" of Germany. In 2021, the BMWK reviewed 42 cases (14% of all cases reviewed by the BMWK) under the sector-specific regime.

Cross-sectoral assessment

The "cross-sectoral assessment" applies to any acquisition of voting rights in a German company above a certain threshold by non-EU and non-EFTA residents. Three different categories need to be distinguished:

- In seven sectors, such as critical infrastructure operators, critical infrastructure software developers, cloud computing providers and media and telecom companies, the acquisition of at least 10% of voting rights, or the increase of voting rights to at least 20%, 25%, 40%, 50% or 75%, has to be notified to and approved by the BMWK.
- In 19 sectors, such as manufacture of certain pharmaceuticals and medical products and advanced technologies (satellites, tracking, IT security, artificial intelligence, quantum computing, vehicles capable of autonomous driving, robots, microchip production and additive manufacturing processes), the acquisition of at least 20% of voting rights, or the increase of voting rights to at least 20%, 25%, 40%, 50% or 75%, has to be notified to and approved by the BMWK.
- In all other sectors, the acquisition of 25% or more of voting rights does not require a notification or prior approval, but the BMWK may decide "ex officio" to initiate a review. If the parties want to ensure that the BMWK will not initiate such ex-officio proceedings, they can request

the BMWK to issue a "confirmation of non-objection" (*Unbedenklichkeitsbescheinigung*).

In its investigation following the notification of an investment, the BMWK assesses whether the investment is "*likely to affect public order or security*" in Germany or any other EU member state. In 2021, the BMWK reviewed 264 cases (86% of all cases reviewed) under the cross-sectoral regime.

PROCEDURE

Within two months after having received the notification (or, absent a notification, two month after becoming aware of the transaction), the BMWK must decide whether to open a formal assessment ("Phase 2"). If the BMWK opens Phase 2, it has to take a final decision within four months after receiving all the required information. Any request for additional information made by the BMWK suspends the four-month period. The BMWK may also extend the deadline by another three months for especially complex assessments. In the recent *Siltronic*-case, the BMWK's review was ongoing for more than twelve month when the parties decided to abandon the transaction.

STANDSTILL OBLIGATION

The parties to an acquisition that has to be notified to the BMWK may not implement the transaction. In addition, the acquirer is not allowed to exercise the voting rights subject to the transaction, and the acquirer may not be granted access to certain sensitive information, violations may be punishable by imprisonment for up to five years or a fine (together the "Standstill obligation"). The Standstill obligation is of significant practical relevance, as it can have a significant impact on the parties transaction timetable. In addition, violations of the Standstill obligation will affect the validity of the legal act by which the acquisition is implemented.

FINAL DECISION BY THE BMWK

The BMWK can approve or prohibit transactions. Approval decisions are either unconditional approvals, or the approval is subject to conditions. By far most cases are unconditionally approved by the BMWK (98% in 2021). In practice, the BMWK prefers, instead of adopting conditional approval decisions, to enter into "public law contracts" with the acquirer. The public law contracts govern the conditions (and reporting requirements) which the acquirer is required to satisfy. If the BMWK prohibits a transaction, the underlying purchase agreement or other legal transactions becomes automatically and retroactively null and void.

KEY ISSUES IN PRACTICE

As a result of the recent reforms, Germany is experiencing a sharp increase in transactions subject to FDI control. The number of notifications increased from 66 in 2017 to 306 in 2021. As in many other jurisdictions, FDI control is now a key issue to be taken into account by any investor directly or indirectly investing in German companies.

The experience during the first months under the new German FDI regime shows that transaction parties often encounter a number of practical difficulties:

- While the legislator significantly increased the number of sensitive sectors, it did not provide much guidance as to what specifically is covered by these sectors. In many cases, investors, target companies and their advisors find it difficult to clearly establish whether a German target company operates in a sensitive sector or not. It does not help that the BMWK does not publish its decision, and that transaction parties therefore do not have any case law they can rely on.
- The BMWK has been adopting a very broad understanding of transactions covered by the German FDI

regime. This has an impact notably on transactions involving indirect acquisitions of German companies or shares in German companies. For example, a 10% shareholding in a German company by the (non-German) target company may trigger a German FDI filing- even if the commercial relevance of the minority shareholding is negligible. Even some intragroup restructurings can be subject to the German FDI regime.

- The main issue in practice is timing of the process. It is very difficult to assess and predict in advance whether the BMWK will initiate Phase 2 proceedings (which significantly extend the length of the proceedings). Experience shows that even transactions that appear to be straightforward cases not raising potential issues from a German FDI perspective may end up in Phase 2.

Overall, all parties involved in the German FDI process – notably the BMWK as regulator and the transaction parties – are still on a steep learning curve. We expect that, with more time passing and cases being dealt with, the process will become more established and predictable. It remains then to be seen whether additional reshaping by the legislator will be required.