GERMANY TIGHTENS FOREIGN DIRECT INVESTMENT CONTROLS

Following the recent changes to the German FDI regulation as a consequence of the Corona crisis, the German foreign direct investment (FDI) regime will be significantly tightened again. The amended provisions are expected to enter into force in June/July 2020. The changes mainly aim at aligning the German FDI regime with the EU FDI Screening Regulation (Regulation (EU) 2019/452). The major changes relate to the prohibition criteria, stand-still obligation, sanctions and longer review periods.

Key issues

- Prohibition criteria for FDI scrutiny substantially strengthened
- Stand-still obligation prior to obtaining the clearance introduced
- Criminal sanctions for the exercise of voting rights, distribution of profits and outflow of sensitive information prior to clearance

LOWERING THE SUBSTANTIVE TEST

Under the current FDI regime, the German Ministry for Economic Affairs and Energy (*Bundesministerium für Wirtschaft und Energie*, "**BMWi**") can *inter alia* prohibit the acquisition of at least 10% of the direct or indirect voting rights in domestic targets by investors from non-EU countries if the acquisition leads to an "actual and serious danger to the public order or security" of the Federal Republic of Germany. In accordance with the EU FDI Screening Regulation, the foregoing substantive test will be lowered so that the BMWi may prohibit an investment even in cases of a "probable adverse effect". In addition, the BMWi's discretion will also include the power to take into account "probable adverse effects" on the public order or security in other EU Member States or with regard to certain projects and programmes of Union interest.

CLOSING PROHIBITION BEFORE CLEARANCE

So far, the prohibition to close the transaction during review proceedings only applied to sector specific investigations, i.e. regarding weapons, other goods for military purposes, IT products relevant for state security issues, etc. Under the new provisions, all transactions concerning the acquisition of at least 10% of the voting rights are subject to the closing prohibition and must not be closed prior to clearance. Any closing steps remain provisionally ineffective until the BMWi grants the clearance or the transaction is deemed to have been cleared.

SANCTIONS FOR EXERCISE OF VOTING RIGHTS AND OUTFLOW OF SENSITIVE INFORMATION PRIOR TO CLEARANCE

In cases of intentional offence, the closing prohibition is being enforced by criminal penalties, including imprisonment up to five years or monetary fines if a purchaser is granted the right to exercise voting rights or receives a distribution of profits prior to clearance. Criminal penalties can also be imposed in case of outflow of security-relevant information to the purchaser prior to obtaining clearance and in case of violation of instructions issued by the BMWi.

LONGER DURATION OF REVIEW PROCEEDINGS

The new legislation will significantly extend the review periods. While Phase I will amount to 2 months and Phase II to 4 months, the latter can be extended up to further 4 months in complex cases. Hence, the statutory review period can amount overall up to 8 months. A further extension is possible upon the parties' consent.

FURTHER CHANGES

Further changes of the German FDI regime relate to the implementation of a national point of contact in the BMWi to coordinate the exchange of information between EU Member States and the EU Commission according to the mechanism of the EU FDI Screening Regulation. In addition, the scope of applicability of sector-specific scrutiny with respect to defence-related products is expanded as it will now include German companies that do not only produce or develop, but also modify and use certain military goods or did so in the past and still have knowledge of, or access to, information on the underlying technology.

Finally, the legislation clarifies that the new rules will only be applicable to transactions of which the BMWi becomes aware after the legislation comes into force.

PRACTICAL CONSEQUENCES

The envisaged changes will lead to a much higher number of transactions which fall under the scope of the new German FDI scrutiny. In practical terms, the closing prohibition will have to be reflected as a condition precedent in respective agreements. In addition, the longer review periods will have a negative impact on the timing of M&A transactions.

The amendments have been heavily criticised by the German industry for restricting investments and, therefore, growth and employment opportunities in Germany. Moreover, they are seen as disproportionate given the enormous penalties.

The German Minister for Economic Affairs and Energy, Peter Altmaier, said that the new rules will be applied in a proportionate manner. However, given the current sector-specific concerns resulting from the Corona crisis and past experience, serious doubts remain as to whether this will be the case.

Outlook

- Higher number of transactions under the scope of FDI scrutiny
- Longer duration of review proceedings
- No retrospective effect of the new rules

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See also our recent newsletter on the Corona-related changes of the FDI regime under the following link: https://www.cliffordchance.com/briefings/2020/05/germany-tightens-foreign-direct-investment-controls-with-particu.html