

NEXT LEVEL – SIGNIFICANT TIGHTENING OF THE GERMAN FOREIGN INVESTMENT CONTROL

Following several changes to the German foreign investment (FI) regime last year, the German Ministry for Economic Affairs and Energy (*Bundeswirtschaftsministerium*, BMWi) published the 17th amendment to the German Foreign Investment Regulation (*Außenwirtschaftsverordnung*, AWV). The 17th amendment came into force on 1 May 2021. Under the new rules, 16 additional industries will be included in the scope of the AWV. In addition, further types of transactions, e.g. increase of existing voting rights exceeding certain thresholds or the acquisition of certain corporate governance rights, will be subject to FI scrutiny as well.

WIDER SCOPE OF APPLICATION

Direct and indirect acquisitions by non-EU/EEA investors of at least 10% of the voting rights in German target companies active in certain critical sectors are subject to a mandatory filing requirement under the AWV (cross-sectoral scrutiny). The 10% threshold applies to critical infrastructure in the water, energy, finance/insurance, healthcare, transport and food industries (each including the respective operating software) as well as certain IT services (e.g. cloud and telematic services) and media.

Due to the Corona crisis, the list of critical industries has already been extended to German companies that develop or manufacture medical personal protective equipment, essential pharmaceuticals, medical products and in-vitro diagnostics, particularly for the treatment of highly infectious diseases. For these sectors, the previously applicable 10% threshold has now been increased to 20%.

Furthermore, the latest amendments extend the mandatory filing requirement to 16 additional industries even further, including certain areas of earth remote sensing systems, artificial intelligence (AI), autonomous driving or flying, industrial robots, semiconductors, cybersecurity, aeronautical/aerospace, nuclear technology, quantum technology, additive manufacturing (3D printing), network technologies, smart meter gateways, information and communication technology, critical raw materials, secret patents and agricultural real estate. If a non-EU/EEA investor acquires at least 20% of the voting in German companies which are active in any of these new categories, a mandatory filing will be triggered.

Key issues

- Wider scope of mandatory filings
- Additional discretion of the government to review transactions if certain corporate governance rights are granted
- Increase of voting shares above certain thresholds will trigger a further reporting requirement
- Special provision for state-owned investors

Transactions within the aforementioned categories must receive investment control clearance before closing. Infringements of the standstill obligation are subject to monetary and criminal penalties.

For non-critical industries, the relevant threshold remains at 25% of the voting rights.

In addition, the sector-specific scrutiny, i.e. regarding weapons and other goods for military purposes, is now expanded to cover all goods listed in Part I Section A of the German Export List (*Ausfuhrliste*). The scope of sector-specific scrutiny is further extended to companies which developed, manufactured or modified such products or had actual control over such goods in the past and still have knowledge of or access to the underlying technology.

In addition, the material test under the sector-specific scrutiny is aligned with the cross-sectoral one. This means that "probable adverse effects" (as opposed to actual risk, which was the previous standard) on essential interests of the security of the Federal Republic of Germany will be sufficient to prohibit a transaction or impose remedies.

THRESHOLDS

Supplemental acquisition of voting rights

In relation to supplemental voting rights acquisitions, the new legislation provides that if an investor already acquired 10%, 20% or 25% (as applicable) of the voting rights in a German target company, an additional increase of the voting shares would trigger the application under the German FI regime if certain thresholds are reached. The additional thresholds depend on the type of industry involved and are as follows:

- critical infrastructure, IT services and media (for which the initial 10% threshold applies): 20%, 25%, 40%, 50%, 75%;
- medical personal protective equipment, essential pharmaceuticals, medical products and in-vitro diagnostics, and the additional 16 industries (for which initial 20% threshold applies): 25%, 40%, 50%, 75%;
- all other non-critical industries (for which initial 25% threshold applies): 40%, 50%, 75%.

In addition, the BMWi will have the discretion to combine a clearance decision with an obligation on the parties to report any increase of voting rights, even if the thresholds mentioned above are not reached.

Acquisition of corporate governance rights

Furthermore, under the new legislation, the BMWi will be able to review transactions in which the investor will acquire "control" over the target via corporate governance rights, notwithstanding the applicable voting rights thresholds. For example, if the investor acquires less than 10% of the voting rights, but at the same time receives special strategic veto or information rights, these rights may qualify as "control". Although the acquisition of "control" would not lead to a filing obligation per se, it would provide discretionary power to the BMWi to call in the respective transactions.

PRESUMPTION FOR STATE-OWNED ENTERPRISES

With regard to state-owned enterprises (SOEs), the new legislation introduces a presumption that voting rights held by two different investors that are "controlled" by the same state will be calculated together to determine whether the voting rights thresholds are met.

The legislative materials contain a statement according to which the presumption can be rebutted. However, it remains unclear under which circumstances the rebuttal would apply.

As noted above, in connection with the acquisition of "control", this presumption would provide the BMWi the discretion to call in the relevant transactions.

PROCEDURAL CHANGES

In some cases, the BMWi had difficulties deciding which type of scrutiny (namely cross-sectoral or sector-specific) was applicable. The new legislation stipulates that the BMWi will have the ability to switch between the two types of proceedings.

In addition, an investor's application for a "certificate of non-objection" from the BMWi, which was the preferred route in past practice, will now only be permitted in cases where the filing obligation does not apply. For transactions that trigger mandatory filings, the parties would have to apply for a "clearance".

OUTLOOK

The public consultation proceeding for the new legislation attracted a record number of 16 statements by various companies and trade associations, most of which contained various points of criticism. Unfortunately, most of the critical comments were not considered by the BMWi.

It can be expected that under the new legislation, a significantly higher number of transactions (both cross-sectoral and sector-specific) will trigger the filing obligation. In addition to these mandatory filings, companies will likely decide in many cases - for the sake of legal certainty - to submit voluntary notifications. This particularly applies given the wide discretion of the BMWi concerning the interpretation of the new sectors. Furthermore, the provisions related to the revised thresholds for supplemental acquisition of voting rights, grant of certain corporate governance rights and the consolidation of voting rights held by SOEs may generate another wave of notifications.

It remains to be seen how the BMWi will deal with the higher number of cases in practice. A further complication may arise from the fact that a significantly higher number of cases would presumably have to be reported under the EU Screening Regulation. Hence, from companies' perspective, more transparency and pragmatism by the BMWi in FI proceedings would certainly be the right tools to mitigate some of the disadvantages posed by the new legislation.

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