TIGHTENING OF GERMAN INVESTMENT CONTROL – NEW LAW PENDING

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On 8 April 2020, the Federal Government submitted a draft change to the Foreign Trade Act (*Aussenwirtschaftsgesetz* or "AWG"). Through this change, the rules on examining investments will be significantly tightened. The new rules will have to be considered in transactions involving direct or indirect acquisitions by non-EU based acquirers – and this will likely be made law soon, alongside changes to the Foreign Trade Regulation (*Aussenwirtschaftsverordnung* or "AWV").

Following a brief summary of the current legal position, we outline the principal proposed changes and give a recommendation for future transactions.

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CURRENT LAW

In examining investments, German investment control law differentiates between sector-specific – in particular for the defence sector – and non-sector specific – for other sectors. The core of the rules can be summarised as follows:

Sector-specific examination

Direct or indirect share acquisitions by foreign investors of at least 10% must be notified. The implementation of such acquisitions must be suspended and the validity of any implementing acts would be provisional until cleared by the Federal Ministry for Economic Affairs and Energy (Bundesministerium für Wirtschaft und Energie or "BMWi") or the deadline of three months (from receipt of complete documentation) has expired without a prohibition decision.

Non-sector-specific examination

A non-sector-specific examination can take place in any economic sector if a non-EU national acquires a domestic business or a direct/indirect holding of at least 25% of the voting rights in a domestic business.

For specific target businesses, acquisition of only 10% will trigger the duty to notify the BMWi of the sale contract. For example, if the target business operates "critical infrastructure" (for example, in energy), particular cloud computing services, or media (where they are opinion-forming and have particular news content and overall impact). Equally, businesses providing software supporting critical infrastructure, telecoms (and its surveillance) and telematics may be covered.

Even if no duty to notify arises, the BMWi may call in the case for review within three months of learning about the deal, with a limitation period of five years from concluding the contract. To avoid legal uncertainty, parties can apply for a comfort letter.

If the BMWi examines the case, the transaction remains provisionally valid; only if it is then prohibited does it become ineffective. The test for prohibition is whether public order or security of the Federal Republic of Germany would be endangered by the acquisition. This requires an actual and sufficiently serious danger to be shown, one which touches a fundamental interest of society.

PRINCIPAL CHANGES

Through the reform, the non-sector-specific investment control rules will be considerably widened.

Extension of standard of review

It is intended that the amended AWG will adopt the standard of review of the FDI Screening Regulation: in future, the BMWi will consider, for non-sector-specific cases, whether the investment in a domestic business can be expected to impair public security and order in Germany or in another EU Member State, or projects/programmes with a Union interest. Until now, an examination was limited to actual endangerment of public security and limited to Germany.

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Suspensory obligation for notifiable acquisitions

If the acquisition is notifiable (particularly those concerning critical infrastructure), it may not, in future, be implemented until BMWi clearance has been obtained. The prohibition on implementation, in part, goes further than that found in merger control. It encompasses, in addition to the exercise of voting rights and the directing the exercise of voting rights, also approval of the payment of profits or economic equivalents, and the disclosure of information which is related to the nature and purpose of the business under review or has been designated in an order as significant.

According to the explanatory memorandum, among other things this concerns access to technology relevant for security or to technical or digital hubs with the potential for significant misuse, as well as the leakage of information relevant for security. The prohibitions apply from the time of the acquisition contract. The explanatory memorandum assumes that in the due diligence and negotiation phases, information with particular relevance to possible damage to public security or order is not likely to be disclosed. The disclosure of commercial or other business-related information, by which the investor can judge the economic merits and risks of the acquisition, will remain permissible.

Deliberate breach of the suspensory obligation is a criminal offence carrying a penalty of up to five years in prison or a fine. Negligent breach will be an administrative offence carrying fines.

Expansion of notifiable transactions

The BMWi has announced that the list of critical infrastructure and technologies in the AWV will be considerably widened. In future, artificial intelligence, robotics, semiconductors, biotech and quantum technology will also be covered. With the COVID-19 pandemic, it is also possible manufacturers of medical products and pharmaceuticals will also be examined; however, a draft amendment of the AWV is not yet available.

RECOMMENDATION

"The disclosure of commercial or other business-related information during a due diligence will remain permissible."

We recommend, similar to merger control, that in every acquisition of a stake through direct or indirect participation by a foreign acquirer, you check whether it must be notified, or at least whether a comfort letter should be applied for. Where it must be notified, a clearance decision (or expiry of waiting period without prohibition) must be a condition precedent to closing. Furthermore, you should avoid actions which – according to the AWG – would breach the suspensory obligation. In this regard, the situation is similar to the well-known prohibition of "gun jumping" in merger control. Consider in particular what information can be disclosed. As mentioned, the disclosure of commercial or other business-related information during a due diligence will remain permissible. In the individual case, permissible information should be distinguished from such information which is of particular relevance to possible damage to public security or order, such as know-how on critical technologies, the dissemination of which the rules aim to prevent. Usually it will anyway be in the target company's own best interest not to disclose such information as long as there is no certainty that the deal will happen and may be closed.

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