

May 27, 2020

GERMAN FOREIGN INVESTMENT CONTROL TIGHTENS FURTHER

To Our Clients and Friends:

On May 20, 2020, the German government has adopted an amendment (the “**Amendment**”) to the German Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung* or “**AWV**”) further increasing the scrutiny of foreign direct investments (the “**FDIs**”). The Amendment focuses on the health sector, addressing apparent pitfalls exposed by the COVID-19 crisis. The tightening of FDI screening rules was also encouraged by the European Commission which called upon the EU member states to take protective measures in response to the COVID-19 outbreak, in particular “to be vigilant and use all tools available at Union and national level to avoid that the current crisis leads to a loss of critical assets and technology” (see [Communication from the Commission of March 13, 2020](#)).

Further, the Amendment precedes a contemplated amendment of the German Foreign Trade and Payments Act (*Außenwirtschaftsgesetz* or “**AWG**”) which is currently discussed in the German parliament and expected to be approved – possibly in a slightly revised version – within the next few weeks (the “**Draft AWG Amendment**”). While the AWV codifies the detailed procedural rules of the German review process, the AWG provides the overall framework of the FDI screening mechanism. The Draft AWG Amendment would further tighten the rules of German foreign investment control and align the German screening mechanism with the EU Screening Regulation, which will apply from October 11, 2020 onward.

In general, the German Federal Ministry for Economic Affairs and Energy (the “**German Ministry**”) has the competence to review and prohibit or restrict investments in domestic companies by a foreign investor on the grounds of public order or security (cross-sector review), or to ensure the protection of essential security interests of the Federal Republic of Germany (sector-specific review). “Sector-specific reviews”, which cover the defense industry and certain parts of the IT security industry, apply to all (EU and non-EU) foreign investors while “cross-sector reviews” (covering all other industry sectors) only apply to non-EU/non-EFTA foreign investors. The general threshold for screening is the direct or indirect acquisition by a foreign investor of at least 25% of the voting rights in a German company. This threshold is lowered to 10% of the voting rights for FDIs that fall under sector-specific review or fit one of the select industry categories listed as part of the cross-sector review (*i.e.*, critical infrastructure etc.); all FDIs falling in either of these two buckets – sector-specific or listed category of cross-sector – need to be notified to the German Ministry. With the Amendment expanding the list of categories of cross-sector review, more FDIs will become notifiable and subject to screening at already 10% of the voting rights.

Key Amendments to the AWW

Aside from heightened scrutiny in the health-care sector, the Amendment introduces investor-related screening factors as set out in Regulation (EU) 2019/452 of March 19, 2019 establishing a framework for screening of FDI into the EU (the “**EU Screening Regulation**”) and provides for minor clarifications.

The Amendment provides for the following key changes to the AWW:

- **Catalog of Select Industries Subject to Cross-Sector Review.** The Amendment provides for five new categories to be added to the catalog of cross-sector review.

Health-Care Related Additions

- Development or production of personal protective equipment;
- Development, production, or marketing of material pharmaceuticals (*wesentliche Arzneimittel*), including holders of respective statutory permits;
- Development or production of medical products designed for diagnosis, prevention, monitoring, prediction, prognosis, treatment or easement of life-threatening and highly contagious infectious diseases;
- Development or production of in-vitro-diagnostics used in connection with life-threatening and highly contagious infectious diseases.

In individual cases, these new categories – except for the development/production of personal protective equipment – may overlap with the category of critical infrastructures. As per the German Ministry, it does not matter, however, if the security-relevant nature of the target company can be derived from one or two categories as the legal consequences do not vary.

Other Addition

- Providing services which ensure the interference-free operation and functioning of governmental communication infrastructure operated by the Federal Agency for Public Safety Digital Radio (*Bundesanstalt für den Digitalfunk der Behörden und Organisationen mit Sicherheitsaufgaben*).

Companies falling in this category for instance provide facility management services, maintenance and fault elimination (*Entstörung*) services, install technical equipment at office locations of the Federal Agency for Public Safety Digital Radio or provide security-related consulting services to the latter.

- **Applicability to Share and Asset Deals.** The Amendment codifies that German FDI control is not limited to the acquisition of shares but equally applies to asset deals.

- **Notification Modalities.** The Amendment clarifies that FDI's triggering a notification obligation are to be notified immediately after signing of the acquisition agreement. The notification generally has to be submitted by the direct acquirer (even if the acquisition vehicle itself is not "foreign") but may also be made by the indirect acquirer instead.
- **Investor-Related Screening Factors.** In line with the EU Screening Regulation, the Amendment formally introduces screening factors that focus on the background and activities of the individual investor. According to the German Ministry, these changes are of clarifying nature only, as investor-related factors have previously been considered as well. Pursuant to the Amendment, the German Ministry may now take into account whether the foreign investor
 - is directly or indirectly controlled by the government, including state bodies or armed forces, of a third country, including through ownership structure or more than insignificant funding,
 - has already been involved in activities affecting the public order or security of the Federal Republic of Germany or of a fellow EU member state, or
 - whether there is a serious risk that the foreign investor, or persons acting for it, were or are engaged in activities that, in Germany, would be punishable as a certain criminal or administrative offence, such as terrorist financing, money laundering, fraud, corruption, or violations of the foreign trade or war weapon control rules.

Contemplated Changes to the German Foreign Trade and Payments Act

To some extent, the Draft AWG Amendment introduces changes that were necessary to comply with the EU Screening Regulation which establishes a common framework for screening and an EU-coordinated cooperation among EU member states through the exchange of information and the possibility to issue comments (or, in case of the European Commission, an opinion) to fellow EU member states on a particular FDI (see *Client Alert* of March 5, 2019).

The Draft AWG Amendment, which may still be altered in the course of the legislative procedure, proposes the following key amendments to the AWG:

- **Expanding the Grounds for Screening.** In line with the EU Screening Regulation, grounds for screening shall be expanded to include public order or security of a fellow EU member state as well as effects on projects or programs of EU interest.

In this context, we note that the European Commission, in response to the COVID-19 crisis, issued guidance concerning FDI from third countries stating that acquisitions of healthcare-related assets would have an impact on the European Union as a whole (see *Communication from the Commission* of March 25, 2020).

- **Tightening the Standards.** In line with the EU Screening Regulation, the standards under which an FDI is prohibited or restrictive measures are imposed will be changed from whether the FDI

constitutes an “actual and duly serious threat” (*tatsächliche und hinreichend schwere Gefährdung*) to whether the FDI is “likely to affect” (*voraussichtliche Beeinträchtigung*) the public order or security of the Federal Republic of Germany, of a fellow EU member state, or projects or programs of EU interest. This would give the German Ministry more discretion and room to maneuver as it could prohibit a transaction in order to prevent an impairment that has not yet materialized but that is likely to occur as a result of the contemplated FDI.

- **Expanding Sector-Specific Screening.** Currently, FDI in companies producing or developing war weapons, armaments or related IT products certified by the German Federal Office for Information Security (*Bundesamt für Sicherheit in der Informationstechnik*) are subject to sector-specific review if at least 10% of the voting rights are acquired. Pursuant to the Draft AWG Amendment, not only the production and development of such goods would qualify for a sector-specific control, but also expressly the modification or use of such goods. The same shall apply if the respective company no longer produces, develops, modifies or uses but still has the relevant knowledge (e.g., because of knowledge of individual employees) or otherwise has access to the security-sensitive technology (e.g., through documents or storage media, if the respective employee already left).
- **Effects on Consummating Transactions.** Currently, FDIs subject to *cross-sector* review (*i.e.*, all industry sectors except for defense/certain IT security) de facto may be consummated at any time – even during an ongoing screening process. The underlying acquisition agreement is deemed valid from the beginning and will only become invalid if the German Ministry prohibits the FDI subsequently (condition subsequent), in which case the transaction must be rewound. On the contrary, transactions subject to *sector-specific* review (*i.e.*, the defense industry and certain parts of the IT security industry) may only be consummated upon conclusion of the screening process (condition precedent). In the past, investors have closed transactions falling under cross-sector review while the review process was still ongoing and thereby confronted the German Ministry with accomplished facts. Therefore, the Amendment now proposes that transactions falling under cross-sector review that are notifiable may only be consummated upon conclusion of the screening process (condition precedent). We expect this to have a tangible impact on the transaction practice given the broad range of notifiable FDIs in the cross-sector category, which would be affected by this change. Foreign investors will need to carefully assess if the target company operates in one of the listed industry categories. From a drafting perspective, acquisition agreements regarding *notifiable* FDIs should include (A) a closing condition that the FDI is (deemed) cleared by the German Ministry, and (B) a mechanism allowing for the amendment or termination of the acquisition agreement in case the German Ministry imposes (comprehensive) restrictive measures.
- **Penalizing the Disclosure of Security-Relevant Information and Certain Consummation Actions Pending Screening.** The Draft AWG Amendment provides for punishment of certain willful infringements of the AWG – and attempted infringements – by way of imprisonment of up to five years or fine or, in case of negligence, with a fine of up to EUR 500,000. The following actions shall be penalized:

- Enabling the investor to, directly or indirectly, exercise voting rights;
- Granting the investor dividends or any economic equivalent;
- Providing or otherwise disclosing to the investor information on the German target company with respect to company objects and divisions that are subject to screening on grounds of essential security interests of the Federal Republic of Germany, or of particular importance when screening for effects on public order and security of the Federal Republic of Germany, or that have been declared as ‘significant’ by the German Ministry;
- Non-compliance with enforceable restrictive measures (*vollziehbare Anordnungen*) imposed by the German Ministry.

Currently, only the non-compliance with enforceable restrictive measures is punishable with a fine of up to EUR 500,000. The introduction of criminal liability will lead to even more focus on whether or not the transaction requires FDI clearing. The seller de facto will be forced to include the clearing by the German Ministry as a closing condition to avoid exposure to criminal liability.

According to the explanatory notes (*Gesetzesbegründung*) to the Draft AWG Amendment, the prohibition to disclose security-sensitive information as described above would usually not apply to purely or other company-related commercial information that is exchanged in the course of a transaction in order to allow the investor to conduct a sound evaluation of the economic opportunities and risks of the FDI. Nonetheless, the seller would need to be cautious when preparing the due diligence process, in particular when populating the virtual data room. Typically, security-sensitive information as described above would not be shared with potential buyers prior to closing of the transaction anyway. Should the need arise, however, the use of a red data room and special disclosure and confidentiality obligations based on a clean team agreement may be required.

- **More Effective Monitoring of Compliance with Measures.** Investors and target companies are to expect more monitoring activity by the German Ministry as the Draft AWG Amendment, once enacted, will provide the German Ministry with a right of information as well as a right to carry out examinations (including access to stored data, respective data processing systems, and business premises, in each case also by use of third-party representatives (*Beauftragte*)) in order to better monitor the investor’s and/or target company’s compliance with contractually agreed or imposed measures.
- **Imposing Restrictive Measures without Consent of the German Government.** Currently, restrictive measures regarding FDIs subject to cross-sector review can only be imposed with the consent of the German government. The Draft AWG Amendment proposes that restrictive measures may be imposed in agreement with and/or consultation of certain federal ministries instead. For the sake of clarity, the German Ministry would still require the consent of the German government if it wanted to prohibit an FDI that is subject to cross-sector review. This would not change.

Further Changes to the AWV to Follow

Further amendments to the AWV are scheduled to follow over the summer. These further changes have been announced already in 2019 but were delayed due to recent events. Initially, *i.e.* before the COVID-19 crisis had reached Europe, the German Ministry had contemplated to expand the catalog of select industries within the cross-sector review to include, *inter alia*, the following critical technologies: artificial intelligence, robotics, semiconductors, biotechnology and quantum technology. Also, the procedure and time frames of German FDI control have arguably yet to be adjusted to ensure that the new EU consultation process is completed before the German Ministry has to render its screening decision. Moreover, the (soon to be adopted) changes to the AWG will need to be implemented in the AWV.

In conclusion, while the German Ministry emphasizes that Germany welcomes foreign direct investments, the trend towards more protectionism continues, greatly intensified by the ramifications of the COVID-19 crisis. For non-EU and non-EFTA investors seeking to invest in German companies, a potential review pursuant to German FDI control will become increasingly important.



Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding the issues discussed in this update. For further information, please feel free to contact the Gibson Dunn lawyer with whom you usually work, any member of the team in Frankfurt or Munich, or the following authors:

Markus Nauheim - Munich (+49 89 189 33 122, mnauheim@gibsondunn.com)

Wilhelm Reinhardt - Frankfurt (+49 69 247 411 502, wreinhardt@gibsondunn.com)

Stefanie Zirkel - Frankfurt (+49 69 247 411 513, szirkel@gibsondunn.com)

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