

UPDATE ON GERMAN FOREIGN INVESTMENT CONTROL: NEW EU COOPERATION MECHANISM & OVERVIEW OF RECENT CHANGES

To Our Clients and Friends:

On October 29, 2020, the 16th amendment to the German Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung* or “**AWV**”) entered into force. The amendment is the final step of implementing the EU-wide cooperation mechanism introduced by Regulation (EU) 2019/452 of March 19, 2019 establishing a framework for screening of foreign direct investments into the EU (the “**EU Screening Regulation**”).

New EU-Wide Cooperation Mechanism

The EU Screening Regulation directly applies as of October 11, 2020 which marks the beginning of a coordinated cooperation among EU member states on foreign direct investments (the “**FDIs**”). This means that, going forward, the German Federal Ministry for Economic Affairs and Energy (the “**German Ministry**”) will exchange information on FDIs undergoing screening in Germany with the European Commission and fellow EU member states which, in turn, may issue comments or, in case of the European Commission, an opinion. While such comments and/or opinions are non-binding, they need to be given ‘due consideration’ and, thus, may influence the screening decision rendered by the German Ministry. For details on the EU Screening Regulation, see our [Client Alert of March 5, 2019](#).

In order for the German Ministry to be able to consider the potential impact of an FDI on the public order or security of one or more fellow EU member states as well as on projects or programs of EU interest, the grounds for screening under German FDI rules had to be expanded accordingly. For the same reason, the standard under which an FDI may be prohibited or restrictive measures may be imposed has been tightened from “endangering” (*Gefährdung*) to “likely to affect” (*voraussichtliche Beeinträchtigung*) the public order or security, as to reflect the EU Screening Regulation. More or less a side effect, this gives the German Ministry more discretion and room to maneuver as it no longer has to determine an “actual and serious threat” (*tatsächliche und hinreichend schwere Gefährdung*) but now 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.

Recent Changes to German FDI Rules

In light of the implementation of the EU-wide cooperation mechanism, we want to use the opportunity to recap this year’s key changes to the German FDI screening process. We refer to our client alert of

May 27, 2020 (available [here](#)) for an overview on the overall screening process and a detailed outline of the most relevant amendments (and contemplated changes) to German FDI rules thus far in 2020.

Changes Effective as of October 29, 2020

- **Expanding the Grounds for Screening.** As described above, the grounds for screening have been expanded to include public order or security of a fellow EU member state as well as effects on projects or programs of EU interest.
- **Tightening the Standard.** As described above, the standard under which an FDI may be prohibited or restrictive measures may be imposed has been tightened from “endangering” (*Gefährdung*) to “likely to affect” (*voraussichtliche Beeinträchtigung*) the public order or security.

Key Changes Effective as of June 3, 2020

- **Health-Care Related Additions.** As a response to the COVID-19 crisis, the catalog of select industries subject to cross-sector review was expanded to include personal protective equipment, pharmaceuticals that are essential for safeguarding the provision of healthcare to the population as well as medical products and in-vitro-diagnostics used in connection with life-threatening and highly contagious diseases.
- **Governmental Communication Infrastructure.** Also added to the catalog of select industries subject to cross-sector review, and thus, triggering mandatory notification to the German Ministry, have been FDIs acquiring 10% or more of the voting rights in companies providing services ensuring the interference-free operation and functioning of governmental communication infrastructure.
- **Investor-Related Screening Factors.** In line with the EU Screening Regulation, the German Ministry may now consider screening factors that focus on the background and activities of the individual investor. In particular, the German Ministry may now take into account whether the foreign investor (i) 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, (ii) 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 (iii) whether there is a serious risk that the foreign investor, or persons acting on behalf of 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.
- **Applicability to Share and Asset Deals.** Since June 3, 2020 it has been codified that German FDI control is not limited to the acquisition of shares but equally applies to asset deals.
- **Notification Modalities.** It was further clarified that FDIs 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.

Key Changes Effective as of July 17, 2020

- **Effects on Consummating Transactions.** In addition to transactions subject to sector-specific review (*i.e.*, the defense industry and certain parts of the IT security industry), all transactions falling under cross-sector review that are notifiable (*i.e.*, FDIs of 10% or more of the voting rights in companies active in industries listed in the catalog of select industries) may only be consummated upon conclusion of the screening process (condition precedent). Note that this has a tangible impact on the transaction practice given the broad range of notifiable FDIs in the cross-sector category, which are affected by this change. Foreign investors 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 closing condition that the FDI is (deemed) cleared by the German Ministry. Buyers should further make sure to include 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 following actions are now penalized by way of imprisonment of up to five years or fine (in case of willful infringements and attempted infringements) or with a fine of up to EUR 500,000 (in case of negligence):
 - 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.

The introduction of criminal liability will lead to even greater 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*), the prohibition to disclose security-sensitive information as described above will 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 will 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 will 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 are advisable.

· **Time Periods.** In view of necessary adjustments to the timeframe of the screening process to integrate the EU-wide cooperation mechanism, the German legislator took the opportunity to overhaul the framework of screening periods altogether. Time periods are now set forth directly in the German Foreign Trade and Payments Act (Außenwirtschaftsgesetz or “AWG”) instead of the AWV. This way, time periods can only be adjusted by way of legislative procedure, i.e. with involvement of the German parliament, and may no longer be changed unilaterally by executive order of the German government. Note the following changes to the timeline of the screening process (which will only apply to FDI of which the German Ministry became aware of *after* July 17, 2020):

- Standardized Time Periods. The same review periods apply to sector-specific (*i.e.*, the defense industry and certain parts of the IT security industry) and to cross-sector (*i.e.*, all industry sectors except for defense/certain IT security) FDI alike. The German Ministry now has two months from becoming aware of the reviewable FDI – instead of previously three months (sector-specific review) or even four months (cross-sector review) – to decide whether to initiate formal proceedings. Making a mandatory notification or filing for a certificate of non-objection will equally trigger the two-month pre-assessment period. In addition, the formal screening period was standardized and may now take up to four months regardless of the sector.
- Extension of Time Periods. The German Ministry may extend the four-month screening period by three months if the individual case is particularly difficult in either a factual or a legal manner. A further extension by one month is possible if the Federal Ministry of Defense puts forward that defense interests of Germany are notably affected. Moreover, periods may now be extended with the investor’s approval.
- Suspension of Time Periods. The screening period is suspended in case the German Ministry *later* requests further information on the FDI. Previously, the screening period was not set in motion before the German Ministry received all (initially or later) requested information on the FDI. This change most likely is meant to allow for requests of fellow EU member states for additional information on the FDI within the cooperation process under the EU Screening Regulation while, at the same time, keeping the delay in the screening process to a minimum.
- Resetting of Time Periods. Time periods will reset and start anew in the event that an FDI clearance or certificate of non-objection was revoked or altered (e.g., in case of willful deceit or the subsequent occurrence of facts). Equally, the time period will also reset if a restrictive measure or a contractual provision with the German Ministry is set aside, partly or in full, by a court decision.

- **Submission of Information.** Being a triggering point for the screening period, the submission of information also was moved from the AWV to the AWG and, therefore, may only be amended by the German parliament.
 - Triggering of Screening Period. Previously, the screening period was only triggered once *all* information had been submitted to the German Ministry. It is now provided that the four-month screening period starts when all *initially* requested information has been submitted which includes, as before, all information set forth in the corresponding general ordinance issued by the German Ministry, and, as of now, all information that the German Ministry additionally may request in its decision to initiate formal screening proceedings.
 - Subsequent Request for Additional Information. The German Ministry may, also later in the screening process, request further information from anyone directly or indirectly involved in the acquisition. Although the screening period will be suspended until submission of the requested information, the overall duration of the screening process remains calculable for the investor who can limit the suspension by actively working towards a speedy submission.
- **More Effective Monitoring of Compliance with Measures.** Investors and target companies are to expect more monitoring activity by the German Ministry which now has 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.** Previously, restrictive measures regarding FDIs subject to cross-sector review could only be imposed with the consent of the German government. Now, restrictive measures may be imposed in agreement with and/or consultation of certain federal ministries instead. For the sake of clarity, the German Ministry still requires the consent of the German government if it wants to prohibit an FDI that is subject to cross-sector review. This has not changed.

What Is Next?

Further changes to the AWV are announced to follow in the 17th amendment to the AWV. In particular, the German Ministry plans to expand the catalog of critical industries which are notifiable and subject to cross-sector review from the acquisition of 10% or more of the voting rights. Based on earlier announcements by the German Ministry on this subject, we expect artificial intelligence, robotics, semiconductors, biotechnology and quantum technology to be potentially declared critical industries. The German Ministry stresses that it will take special consideration of feedback provided by the affected industry circles when proposing the expansion of critical industries to the German government.



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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:

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