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April 2021

The German Government passes a revised regulation on foreign investment control

GERMANY, REGULATORY, AGRICULTURE / FOOD PRODUCTS , PHARMACEUTICAL, HEALTHCARE, MERGER NOTIFICATION, ALL BUSINESS SECTORS, INFORMATION TECHNOLOGY, THRESHOLDS, MERGER (NOTION), CHANGE OF CONTROL, REFORM, FOREIGN INVESTMENT, CONTROL (NOTION)

German Federal Government, *17th amendment to the Foreign Trade and Payments Ordinance*, Amendment 17 AWV, 27 April 2021 (German)

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e-Competitions News Issue April 2021

Regulators are becoming increasingly active in imposing measures on deals or prohibiting them altogether under FDI rules – with prohibitions happening in the EU's largest economies Germany, France, and Italy in the past months. Against this backdrop, Germany is moving forward on its plans for stricter foreign investment control laws. On 27 April, the German government voted on a revised regulation, following a draft that was presented in January for public consultation. Amongst the key results of this consultation are a couple of changes to the draft that should be welcomed. Firstly, the revised regulation makes it clear that intra-group restructurings do not fall into the scope of the German FDI rules anymore. Moreover, concerning the additional areas of target activities which require a mandatory filing, the voting share threshold has been increased from the initially suggested 10 to 20 percent.

In Germany, the implementation of additional target activities within the scope of foreign investment control, as set out in the *EU FDI Screening Regulation (EU) 2019/452*, was delayed last year. Coordination between the different ministries of the German Federal Government (Bundesregierung) proved to be more difficult than expected. After the Federal Government finally presented a compromise in the form of the draft bill for the 17th reform of the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung* – AWV) in January, the final bill has now been approved by the Federal Government.

The reform has been published in the Federal Gazette and entered into force on May 1st. The Federal Council and the Federal Parliament will still have to deal with the ordinance within four months. However, it is not expected that the regulation will be overturned. The new rules thus apply to all transactions signed from May 1st.

Below is a summary of the key amendments of the proposed reform and newly covered target activities:

Summary of changes

For M&A transactions involving German target companies directly or indirectly via the acquisition of a foreign group, the bill contains some good and bad news:

- Future deals will be made more difficult by the fact that the catalogue of companies whose acquisition is subject to notification will be **significantly expanded** once again. For the extensive new area of critical technologies, a **20 percent threshold** will apply in future. Notably, this is a deviation from the lower 10 percent threshold currently applicable for critical infrastructure and the general 25 percent threshold as well as a change compared to the January draft. According to the business community's intervention in the associations' consultation regarding the draft bill, the higher threshold compared to critical infrastructure is intended to facilitate the financing of start-ups in investment rounds.
- Moreover, in addition to the acquisition of voting rights, the acquisition of **control and management rights** can now, for the first time, also trigger a notification or an *ex officio* review. Furthermore, the draft confirms that **share increases** beyond existing stake-holdings are subject to foreign investment control, even if the thresholds were already exceeded before the transaction. The government has set specific thresholds which would individually trigger a notification (20, 25, 40, 50, or 75 percent of the voting rights), even if the initial transaction was already approved. Additionally, the competent Federal Ministry for Economic Affairs and Energy (*Bundesministerium für Wirtschaft und Energie* – BMWi) can now condition the clearance of acquisitions on a notification obligation regarding any further share increases.
- On the other hand, it is positive that the German government has decided against using **very broad terms** such as "critical technologies" from the EU FDI Screening Regulation. Instead, the draft contains a list of concrete individual target activities. Even though the list is extremely long and will probably grow in the future, the concrete definition of the target activities triggering a review avoids uncertainties in the implementation of investment control as they occur in *other EU Member States*. Without this (and given the importance of new technologies in almost all industries), it was conceivable that almost every deal would have needed notification to the Federal Ministry of Economics.

Newly covered cross-sectoral activities of target companies

The draft introduces 16 additional groups of activities in the area of cross-sectoral screenings, i.e. outside of defence technology. Together with the five new case groups (four of them from the health and biotechnology sectors) already added with last year's amendment, the number of covered activities increases more than fourfold compared to the status one year ago.

Activities covered up to now, such as critical infrastructure and specially developed software for such critical infrastructure or the media sector, remain subject to control.

The 16 new groups of activities will in future be subject to notification if a non-EU acquirer acquires at least 20 percent of the voting rights or comparable management or control rights (see 3. below) over a German company. This concerns companies in the following areas:

1. High-quality **earth remote sensing systems** (as regulated in the Satellite Data Security Act).
2. **Artificial intelligence (AI) technology** that has the potential for misuse, e.g. AI that can be used to

automatically (i) carry out cyberattacks, (ii) imitate individuals for targeted disinformation, (iii) perform or analyse voice communication or biometric remote identification of individuals for, which can objectively also be used for the purpose of surveillance or internal repression, or (iv) analyse movement, location, traffic, or event data of people for the purpose of surveillance, which is objectively also suited to exert internal repression. It is important to note that it is not necessary to demonstrate a specific intention to misuse the data, but that it is sufficient if the overall circumstances make such misuse possible as a result of the acquisition.

3. **automated driving or flying** (i.e. autonomous mobility, including drones) as well as essential components or software therefor.
4. **Industrial robots**, including software, technology, or specific IT services therefor, specially designed for one of the following purposes: (i) handling high explosives, (b) radiation-hardened to withstand more than 5 x 10^3 Gy (silicon) without degradation of function, (iii) operate at altitudes exceeding 30 000 metres, or (iv) operate in water depths of 200 metres or more.
5. Certain **semiconductors** such as integrated circuits on a substrate and discrete semiconductors as well as optoelectronics.
6. IT products or components for **cybersecurity**, i.e. in particular the IT security industry as well as the IT forensics industry.
7. **Aeronautical companies** as defined in Regulation (EC) No 1008/2008 and **aerospace companies** that develop or manufacture certain dual-use goods or goods or technology intended for aerospace use or for use in space infrastructure systems.
8. **Nuclear technology**.
9. **Quantum technology** including quantum computing, quantum computers, quantum sensors, quantum metrology, quantum cryptography, quantum communications, and quantum simulation.
10. Additive manufacturing (**3D printing**) for industrial applications based on metal or ceramic materials as well as main components and powder materials used therefor.
11. **Network technologies**, especially in the area of 5G networks.
12. **Smart meter gateways** certified or in the process of being certified, or security modules therefor.
13. **Information and communication technology** services important to the Federal Republic of Germany, e.g. digital radio for governmental agencies. This will cover employees of the target company who work in connection with "vital facilities" pursuant to the Security Clearance Act (SÜG).
14. **Critical raw materials** as detailed on the European Union's *List of Critical Raw Materials*.
15. **Secret patents**, e.g. technologies for the enrichment of atomic isotopes, crypto keys, and encryption technologies or technologies for the production of banknotes.
16. **Food security**, i.e. enterprises that directly or indirectly manage an agricultural area of more than 10,000 hectares.

The new categories stem largely from the EU FDI Screening Regulation. The regulation defines the category of "critical technologies and dual use items" as "including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies".

Changes in the area of sector-specific activities of target enterprises

In the area of **sector-specific review** - i.e. in particular affecting targets in the field of defence technology - reference is to be made in future to **all military equipment** as defined in Part I Section A of the German Export List (*Ausfuhrliste*). Up to now, only a few individually listed items in the field of armaments were covered.

In addition, the Federal Government intends to apply last year's broadened substantive review standard from the cross-sectoral investment assessment also for sector-specific activities. This lowers the standard of review to "probable threat" - a concrete impairment is no longer required.

The different assessment criteria of sector-specific (essential security interests) and cross-sectoral investment assessment (public order or security) remain unaffected by this amendment.

Atypical acquisition of control as a new offence of seizure and control

According to the wording of the AWV, foreign investment control applied only if an investor acquires 10 percent or 25 percent (in the future also 20 percent) of the voting rights of a German target enterprise. The amendment intends to clarify that, in accordance with the previous practice of the BMWi, **incremental share acquisitions** above these thresholds also fall within the scope of application of foreign investment control because such increases in voting rights can give an investor additional influence over the target. The government has set specific thresholds which would individually trigger a notification (20, 25, 40, 50, or 75 percent of the voting rights), even if the initial transaction was already approved. Additionally, the BMWi can now condition the clearance of acquisitions on a notification obligation regarding any further share increases independent of the thresholds.

Particularly relevant in practice is also that **control rights outside of formal voting rights** will, going forward, also trigger a review. This concerns investor or shareholder agreements which can give the acquirer a disproportionate influence in comparison to the actual share of voting rights and, therefore, influence comparable to a higher share of voting rights. The Federal Government refers to the appointment of supervisory bodies or management as well as to veto rights in strategic business decisions or extensive information rights. For the interpretation of these terms, a comparison with merger control law can help where the assessment of (co-)control rights has always been standard practice.

Procedural questions

The existence of a mandatory notification obligation in the area of cross-sectoral review (i.e. according to one of the specifically regulated case groups of the new Section 55a (1) AWV) and a parallel voluntary application for the granting of a clearance certificate for activities not specifically mentioned are mutually exclusive in the future. The new regulation serves to clarify that an **application for a clearance certificate is excluded in the case of a reportable acquisition** and in the case of an examination procedure already initiated *ex officio*.

In addition, the new regulations clarify that the BMWi can **switch from the cross-sectoral to the sector-specific examination and vice versa**. The practice of the last few years shows that for more and more cases it is difficult to conclude whether the cross-sectoral or sector-specific investment assessment applies.

Sometimes the authorities can only determine in the review procedure, after receipt and examination of detailed information, which procedure is actually applicable in the case at hand.

Supervision of remedies

If the government has significant concerns regarding a transaction and imposes conditions or requires a mitigation agreement, the revised law provides for **more concrete rules on the supervision of such measures**. It will be possible for BMWi to instruct a qualified third party to take over the monitoring role on behalf of the government. So far, the role of a trustee was limited to the supervision of the disintegration of prohibited deals. This takes into account that more and more deals are only cleared subject to a mitigation agreement and the BMWi's resources for supervising such agreements are limited. The Regulation also enshrines certain reporting obligations of the parties in such case which have already been standard in most mitigation agreements concluded.

Outlook

With the vastly expanded catalogue of covered activities, it will be important for acquirers, sellers, and target companies to jointly identify at an early stage whether the target company meets one of the newly introduced criteria. Involving experts from the company as well as legal (and possibly technical experts) will be indispensable for this exercise.

It is also of practical significance that the German government is already sharing notifications for investment assessment with the European Commission in order to enable coordination with other Member States that may be affected. The Commission, in turn, makes use of its right to comment on procedures and has already shared adverse opinions regarding deals with the Federal Government. As a result, not only will more procedures be subject to scrutiny in the future, but the review procedures will also take longer due to several European authorities being involved.

While 2021 promises to be a year with a particularly large number of M&A transactions after the COVID-19 shock of the past year, and while the *review of transactions under antitrust law* in Germany has just been considerably simplified by higher thresholds, the German government is keen to scrutinise foreign investments even more thoroughly with the help of investment control instruments.