金杜律师事务所
KING&WOOD
MALLESONS

April 2020 – last updated 29 April 2020

Foreign Investment Control in times of Corona

This article was written by Tilmann Becker and Christian Cornett

Executive Summary

Within the European Union, foreign investment control regimes have been continuously tightened in recent years. The German government has just proposed new legislation for its national control regime, likely to come into force in Q4/2020. This insight outlines the expected changes and puts them in a practical context.

The KWM team has monitored the recent developments closely and conducted a number of foreign investment cases in Germany over the last few years. On the background of the experience we have gained in this context, we firmly expect that most transactions of foreign investors can also be implemented in the future very much as they have been in the past, even if all proposed amendments to the German and European control regimes were to come into force at the end of this year.

Except for cases subject to significant political scrutiny, the bottom line is that also after the new law comes into force, there will be few material changes to the situation foreign investors are already facing today. Nonetheless, the fact that foreign investment control proceedings will demand more attention and efforts in the future should not be ignored. It is important that sufficient attention is paid to the communication, structuring and implementation of any Sino-German and other foreign transactions. A **FIC-optimised approach to cross-border M&A deals** should, thus, become an indispensable part in the plans of any foreign investor in order to obtain as much deal-security as early in the process as possible.

A. Introduction

In the midst of the Corona pandemic, the German government has initiated a process to amend the German foreign investment control (**FIC**) regime. The bill proposed by the German government is the first step in the national legislative process, clearing the way for the parliamentary procedure, which is widely expected to be completed in a timely manner, allowing for the proposed amendments to become effective in Q4/2020.

Primarily, the purpose of the proposed bill is to adapt the German FIC law to the European Regulation for the Screening of Direct Foreign Investments in the European Union (European Regulation 2019/452, as published in 2019, becoming effective on 11 October 2020 (in the following the **FDI-Regulation** (for more details on the FDI regulation please see KWM on FDI Control). Secondly, the German government is aiming to close certain gaps in the existing legal regime to improve the effectiveness of FIC procedures. The proposed amendments shall, according to Federal Economics Minister Peter Altmaier, also improve the protection of German critical infrastructures and procure that the supply of goods and services in important areas is not impeded by foreign investments. Additional statements made in connection with the publication of the proposed bill further indicate, that a protection of vulnerable companies from foreign take-overs in times when German companies may be undervalued due to the Corona pandemic and the prevention of a sell-off of economic interests also played an important role in the final wording of the published bill.

This recent development in Germany is in line with discussions and proposals for new laws which have been going on in many member states of the EU – and the EU itself has been increasingly active on this topic for some years now. For example, back in December 2019, the EU's competition chief, Margrethe Vestager, was examining how to curb what is perceived by several politicians to be an unfair competition from non-EU state-owned enterprises. At that time, Margrethe Vestager was further quoted saying that some companies outside the EU were able to use government backing to gain an undue advantage when acquiring European competitors. The EU also passed the European FDI-Regulation, with one of the main aims being to provide an opportunity to review foreign investments in the entire European Union and not only in such member states which had independently introduced a control regime in their national laws. On the backdrop of the Corona pandemic and the fact that the FDI-Regulation shall only apply as of 11 October 2020, the EU on 26 March 2020 published additional Guidelines for the EU member states on how they may protect certain strategic assets, such as companies active in the health, medical research and biotechnology sector from foreign investors. In essence the EU has urged all member states to set up screening mechanisms as soon as possible. In the context of the release of these Guidelines, the recently appointed president of the European Commission, Ms. Ursula von der Leyen, also stressed that strategically important technologies and companies must be protected.

And yet, in spite of all these recent activities, political demands for additional regulatory responses to a presumed push by, in particular, Chinese state-supported companies to "*snap up European assets*" are still being brought forward in many EU member states. Some of the suggestions made in this context are increasingly interventionist. In April 2020, for example, Ms. Vestager has been quoted suggesting that European countries should buy stakes in companies to stave off the threat of Chinese takeovers. Furthermore, European regulators are working on proposals to grant EU countries certain powers to derail unfair competition from state-backed enterprises. The final approach of the EU in this context is expected to be clarified in more detail in June 2020 when new EU legislative proposals will presumably be published.

On this backdrop, in line with the increasing EU Screening of foreign investments, the continuous tightening of the German legal environment for foreign investments, evidenced most recently by the bill proposed in March 2020 by the German government, comes as no surprise. However, as we will set out below, the actual effects of the main changes proposed should not be overemphasized. As Germany already implemented a relatively comprehensive FIC regime in the summer of 2017 and seeing how the powers made available have been readily utilized in the meantime, the rules of the game may have changed, however, in essence, the same game is still going to be played.

B. The proposed amendments to the German FIC Regime (as suggested in March 2020)

I. Introduction to the recent developments of the German FIC regime

The German provisions for FIC procedures are predominately set out in the German Foreign Trade and Payments Act (*Außenwirtschaftsgesetz*, **AWG**) and the Regulation for Foreign Trade and Payments (*Außenwirtschaftsverordnung*, **AWV**). While the AWG describes the general principles for foreign investments on a very high level, the AWV specifies these general principles in greater detail. The provisions of the AWV are, partially, further specified in other legislative acts (e.g. the German Regulation for critical infrastructures (*BSI-Kritis-Verordnung*, **KritisV**)) or public lists or other information sources (e.g. the European Annexes to determine whether products are Dual-Use Goods or the German War Weapons List). The fact, that multiple sources of information need to be monitored and taken into account when assessing the FIC situation, has resulted in a somewhat opaque legal environment which is sometimes difficult to apply, in particular, as each individual source of information is frequently adapted and/or updated.

Until the summer of 2017, this burdensome situation, however, only affected very few foreign investments in Germany. But since then, the applicable legal regime has been amended twice, once in August 2017 (see our KWM German FIC Update 2017) and then again in December 2018 (see our KWM German FIC Update 2018 and KWM GER FIC Update 2019) with each amendment resulting in a considerable expansion of the range of investments potentially subject to intense scrutiny.

Moreover, this development of the written law has been accompanied by a perceivable shift in the approach of the competent Federal Ministry for Economic Affairs and Energy (*Bundesministerium für Wirtschaft und Energie*, **BMWi**) to foreign investments. While the BMWi's view on investment screening on the German regime is still that Germany is an attractive destination for foreign investments, in recent year it increasingly has stressed that for the German social market economy to function, vigilance is required. One example for this change of approach is the evident willingness of the BMWi to construe the applicable law in a "*review-friendly manner*", e.g. by assuming against the explicit wording of the AWV that not merely the acquisition of voting rights is subject to a review, but rather that any kind of transaction, which has a comparable effect to an acquisition of voting rights, may be assessed. Another example is that the BMWi is known to scrutinize transactions in business sectors which are not "critical" as defined in the FIC provisions, but which are (merely) of general economic importance for Germany, e.g. the automotive sector. Intensive reviews in such sectors have only been made possible on the basis of a generous interpretation of the existing laws.

II. Current general principles governing FIC procedures in Germany

As each foreign investment is subject to its own specifics and characteristics, depending *inter alia* on the nature of the business which shall be acquired, and to some extent on the nature of the acquiror/investor, it is seldom feasible, regularly extremely difficult and sometimes not possible to issue general statements on how FIC procedures will typically develop. Rather, each individual transaction must be assessed on a stand-alone basis.

That being said, under the applicable legal regime, the following core general principles currently apply to the three kinds of FIC procedures applicable in Germany.

Topic	Sector-specific deals	Cross sector deals	
		Critical Business Sector	Non-critical Business Sector
Business sectors	Military and Defence	• Critical Infrastructures (e.g. water, energy, medicine, healthcare; financial institutes); • Software providers for critical Infrastructures; • Cloud-computing services.	All other business sectors.
Relevant % threshold	10 % of voting rights (or any comparable transaction).	10 % of voting rights (or any comparable transaction).	25 % of voting rights (or any comparable transaction).
Nationality of Investors	Foreign Investors	Non-EU Investors	Non-EU Investors
Notification Duty	Yes	Yes	No
Prohibition to close prior to approval	Yes	No	No
Certificate of non-objection possible?	No	Yes	Yes
Review periods	• Phase I: Three months. • Phase II: Three months.	• Phase I. Two months if certificate of non-objection is applied for; otherwise Three months. • Phase II: Four months.	
Limitations for DD / other rights	No explicit restrictions.		
Required threat for prohibition	Actual threat to German public security interests.		

III. Key elements of the proposed amendments to German FIC law

1. Relevance of both German and European Interests

In connection with the adaption of German FIC law to the principles of the European FDI-Regulation, the BMWi shall, in the future, be obliged not only to assess whether a foreign investment has implications on German public security interests or the public order. Rather, a detrimental impact on comparable interests of any other member state of the EU or certain projects or programs of the EU itself shall also be taken into account. In addition, an information and co-operation mechanism between the member states and the EU will be implemented, ensuring that the BMWi will be adequately informed whether such additional "EU-interests" exist. The aim of the co-operation mechanism is to increase transparency and ensure better protection against critical company takeovers.

2. Lowering of the threshold for prohibitions etc.

The relevant level required for a prohibition of a foreign investment, respectively any order, decree or contract demanded by the BMWi with the purpose of protecting specifically identified security interests or a public order, shall be lowered. As a result, the BMWi may take actions not only once it deems a relevant German or European interest to be actually threatened. Rather, it will suffice that such a threat is assumed to be likely. The suggested criterion of a "probable impairment" of public order or security interests will considerably expand the powers of examination of the BMWi.

3. Expansion of the scope of critical investments

The scope of investments which shall be deemed to be critical and which will, as a result, generally be subject to an intense scrutiny, will be considerably expanded. In addition to the current provisions, which only address investments in certain infrastructures as critical, in the future investments in companies having a connection to certain technologies (e.g. artificial intelligence, semi-conductors and robotics) shall also be considered to be critical. The proposal published by the German government does not yet set out in detail which technologies will be affected by the impending expansion, as the relevant details will have to set out in a separate amendment of the regulation, the AWV. Specifically, on the backdrop of the Corona pandemic, the BMWi has decided that it will no longer try to implement the necessary amendment of the AWV in one single step. Rather, on 27 April 2020 a proposal of the BMWi was published by which certain, mainly health-sector related, changes to the AWV should be implemented as soon as possible, while other envisaged amendments should follow later in the year (AWV CORONA AMENDMENT). In addition to the introduction of six new critical business sectors (four of them health-related), the proposal further includes provisions which shall implement certain parts of the European FDI-Regulation as well as some clarifications which already have to be observed in practice but have not been established as written law.

Beyond this amendment of the AWV the BMWi is supposedly planning to publish a proposal for additional adaptions of the AWV soon. It should, however, be expected, that all technologies addressed in Article 4 of the FDI-Regulation will also be specifically set out in the amended AWV.

4. **Expansion of the prohibition to close transactions and complementary restrictions**

The expansion of the investments which shall be deemed to be critical is complemented by a new provision in the AWG that such critical transactions may not be closed, unless the BMWi has officially approved the transaction (or such official approval can be deemed to have been granted).

The prohibition for closing certain transactions is flanked by a couple of new provisions which shall procure that no "de-facto" closing occurs, meaning that the investor cannot be granted any rights or entitlements as if he already owned the German target company before closing. For example, the seller of a German target company may not enable the investor to (indirectly) exercise any voting rights in the German target company before closing or agree to follow any instructions from the investor in this regard.

These newly introduced prohibitions suggested in the proposed law aim to prevent the parties involved in the acquisition from creating irreversible facts during an on-going FIC process as this would undermine the objectives of the FIC process.

A further, very important aspect of the proposed bill is that restrictions are imposed on the seller and the German target company regarding their entitlement to share certain information with the investor. This aspect will likely have a perceivable effect on future due diligence processes. In essence, the disclosure of information in a due diligence process will generally remain possible, but depending on the nature of the FIC process, the following restrictions have to be observed:

Sector-specific deals	Cross sector deals	
	Critical Business Sector	Non-critical Business Sector
Generally, no sharing of information relating to the military/defence business.	No sharing of information relating to the critical business, provided that the information is of particular relevance for the assessment.	Generally, no restrictions for the sharing of information unless it is explicitly ordered by the BMWi with regard to specific information.

II. First analysis of the proposed amendments

The proposed amendments of the German FIC law at first sight appear to contain numerous provisions which will materially change the legal environment for foreign investments in Germany, if/once they are adopted by the German parliament. However, a closer look suggests that the new provisions will in large parts merely capture the current legal environment foreign investors are dealing with in writing. Nonetheless, some of the changes proposed are truly significant and their effects on future FIC procedures can currently not be exactly predicted.

1. **What are the key new implications of the proposed amendments to German FIC law?**

Lowering of the threshold for prohibitions etc.

One of the core new changes contained in the published proposal is the lowering of the requirements for the BMWi to be able to prohibit a transaction or take any of the other measures at its disposal to protect German or European security interests or the public order. If this proposal of the German government is passed, the BMWi will no longer have to determine an actual threat for protected interests, it will be sufficient that such a threat is merely likely.

In the FIC procedures KWM has been involved in since 2017, the BMWi would regularly have been able to identify numerous aspects to at least argue that the transaction may potentially establish a threat for protected public interests (e.g. based on the involvement of state institutions on the side of the investor, the potential acquisition of relevant IP and know-how etc.). It was, however, a much tougher task for the BMWi to argue that such a threat actually existed. The new principle proposed by the German government, therefore, has the potential to significantly increase the scope for decision-making of the BMWi.

As a consequence, we assume that it is more likely than not, that in the future more transactions will be subject to certain orders, decrees or demands from the BMWi and that some transactions will potentially be prohibited were such orders etc. are deemed not to be sufficient.

A key aspect for future M&A transactions could, in our view, thus be for the parties to agree on what kind of demands from the BMWi are still appropriate and must be accepted by the foreign investor and when demands are perceived as *in*appropriate and what the legal consequences of such *in*appropriate demands of the BMWi would be.

Expansion of the prohibition to close transactions and complementary restrictions

What is also new is the expansion of the prohibition to close critical transactions. In combination with the expected expansion of the scope of businesses which will be deemed to be critical, it has to be assumed that a considerable number of future foreign investments will, in theory, be subject to the prohibition to close. The complementary provisions (no execution of voting rights, no instructions in this regard etc.) will, thus, also play a role in many future foreign investments.

In practice, the impact of these new principles will, however, likely be much smaller than one might initially assume. In our experience, the parties which have recently been involved in a FIC procedure turned out to be very reluctant to close a transaction which is subject to a FIC process and which might later be prohibited and may have to be rescinded. Rather, the parties usually agreed that the obtainment of the FIC approval is a condition precedent for the closing of the transaction. This has proven to be the preferred strategy, even where the risk that the BMWi may prohibit the transaction has been deemed to be minor. Therefore, a “de-facto” prohibition to close has already been widely applied in connection with past foreign investments. In addition, one should not completely ignore that the law currently governing FIC procedures already entitles the BMWi to take any measures it deems necessary to protect public interest once it has obtained knowledge of a foreign investment. De facto, the BMWi is, thus, already authorized to issue orders of the kind which will now be explicitly set out in written law, e.g. an order which prohibits the seller from following any instructions of the investor regarding the utilization of voting rights. The main difference to the current legal situation is that in future no active decision of the BMWi will be required anymore, as the law itself already prohibits any such measures right from the start.

The one complementary restriction to the prohibition to close which, in our view, may have a significant impact on future foreign investments is the prohibition to share certain information in the due diligence process. Such a restriction shall, in particular, apply to critical cross-sector investments, the scope of which will likely be considerably expanded when the new law comes into force. The (current) wording of information-sharing restriction in the proposal of the German government is so generic, that it – if adopted as it stands – may well often be quite difficult for the parties to determine which information is affected by the restriction and which information can still be freely shared. Due to the fact that the proposed bill sets out considerable legal consequences if a restriction set out therein is breached, it is quite likely that German sellers and target companies will take a very cautious approach and prefer not to disclose certain information when in doubt. This may well result in less information being made available in the data rooms. As a result, foreign investors contemplating an investment in a critical business should expect that their access to information of the German target company will be restricted to a certain extent and that new solutions will need to be applied. For example, going forward critical information may potentially only be reviewed by a clean team instructed to act for the foreign investor (the clean team members simultaneously undertaking not to disclose the specific content of the relevant information to the investor and only reporting its findings in an abstract manner). As this practice is well-established in other areas, e.g. due to competition restraints, feasible routes are available to overcome this restriction. That being said, if implemented as currently worded this change may well extend, prolong or complicate future investment processes for foreign investors.

2. **What is not (or not significantly) new?**

Relevance of European interests for the decision of the BMWi

The fact that the BMWi will, in the future, be entitled not only to assess an impact of the transaction on German security interests and public order but also on comparable European interests may appear to contain a considerable expansion of the powers of the BMWi. In our experience, however, the German government has already been in close and constant contact with other EU member states with regard to foreign investments for a long time, in particular with such member states, which share the same philosophy on foreign investments, such as France, Italy and the Netherlands. Indeed, it was the countries Germany, France and Italy which were the main drivers behind the passing of the European FDI-Regulation and many of the provisions set out in this FDI-Regulation were already applied in Germany on a de-facto basis even without the existing laws being amended. Therefore, this proposed amendment, in our view, will not materially change the situation for foreign investors. Germany, as of today, is already sharing information with other EU member states and taking their views into account if they are relevant for the specific proceeding.

De facto, just like the BMWI in recent years has been co-ordinating the review of a foreign investment by a number of German ministries and authorities, the draft also provides for the establishment of a formal "National Contact Point" on the level of the BMWi for the cooperation mechanism created by the FDI-Regulation. Going forward, the formal announcement will contribute to the authority of the BMWi, which may be of relevance with respect to some other EU-countries.

Expansion of the scope of critical investments

The new bill further proposes, that not only investments in companies active in a critical infrastructure shall be subject to the provisions for critical investments, but the same principles

shall also apply for companies operating a critical technology, such as artificial intelligence, semi-conductors and robotics. On the one hand, the effects of this expansion will be limited, as investments in such companies currently already are subject to intense scrutiny, even without them being officially declared as being critical. In this regard, the proposed new law will, therefore, not change much. On the other hand, it must be acknowledged that this expansion will result in investments in a critical technology being subject to a notification obligation, the prohibition to close the transaction prior to obtaining an approval of the BMWi and the corresponding restrictions set out in the proposal of the German government. Since these "limitations" are, in our experience however, already being observed on a de-facto basis, we deem that the actual impact of this amendment will, in fact, also be low.

C. KWM's *Outlook on the German FIC regime*

While the proposal for an amendment of the German FIC law initially appears to contain a considerable shift in the German approach to foreign investments, a closer look reveals that the proposed changes are not as onerous as one might fear, although still a bit of a mixed bag.

On the one hand, it cannot be denied that certain new mechanisms will result in FIC procedures becoming more common, as more transactions will have to be notified to the BMWi and more transactions will be deemed to be, in principle, critical and worthy of a review. Some critical FIC procedures will likely also become more challenging, e.g. because merely likely threats for protected public interest may already trigger the powers of the BMWi and because of the expansion of the prohibition to close transactions without the approval of the BMWi. This will likely result in more orders and decrees issued by the BMWi or demands for public contracts from the BMWi, which shall serve the purpose of protecting identified public interests. In some cases, prohibitions may well occur.

The parties of a cross-border M&A deal will further have to find solutions for the wider discretion of the BMWi and the corresponding reduction of deal-certainty as well as the potential limitations for the due diligence process. Foreign investors may further be faced with some very cautious sellers which will fear the threats of potential punishment set out in the proposed amendment of the AWG and which will need some convincing to sell the German target company to a foreigner. Finally, a stringent communication strategy (also with regard to the public) may well become more crucial for the success of future transactions which are subject to significant political scrutiny and are closely monitored by the press.

On the other hand, the new regime will, in many aspects, merely cement in writing what has been the de-facto legal environment foreign investors have been facing since the summer of 2017. In this regard, the amendments of German FIC law may even turn out to be a blessing in disguise, in particular if the announced adaption of the AWV provides a comprehensive and transparent description of the transactions which are deemed to be critical. This might provide a remedy for the current opaque and partially confusing situation which foreign investors often feel they are confronted with, in which it is nearly impossible to predict which transactions will trigger a review by the BMWi and which transactions can be closed without initiating an onerous FIC process. In addition, detailed provisions in the AWV may promote the preparation of the FIC process for all parties involved and result in a quicker, smoother and more predictable procedure. In this regard, much will depend on the quality of the amendments of the AWV and as a result, the proposal of the BMWi is eagerly awaited. Judging by the proposal for an amendment of the AWV published by the BMWi on 27 April 2020, which shall (merely) implement certain new, mainly health-related aspects of the FIC regime considered to be extremely urgent, the results of the activities by the BMWi may

be mixed. For example, of the six new critical business sectors introduced in the AWV, exactly three contain references to more detailed laws or public lists which will aid the understanding and application of the new provisions while the other three merely contain generic descriptions, which may provide for a general understanding of their content and a limited amount of transparency but will not be very helpful for determining the exacts rights and duties of a specific investment.

Conclusion

As we firmly expect that most transactions of foreign investors can be implemented as they have been in the past and we do not expect significant changes of the practice of the BMWi. As under the regime as it currently stands almost all past FIC procedures have ultimately resulted in a clearance of the transaction reviewed, foreign investors should generally not be deterred by the continuous tightening of applicable law and the political background noise accompanying such amendments.

After the new legislation comes into force, however, a prudent review of the FIC situation in due time before a transaction is finalized and the establishment of a balanced strategy for a potential FIC process, should form an even more important part of any foreign investment in Germany. Such strategy should obviously primarily focus on the investor's interests, however, also take into account not only the powers and sensitivities of the BMWi but also keep in mind the interests of cautious sellers and target companies.

As an FIC filing requires disclosure both with respect to the target and the investor, in any FIC filing, the investors situation needs to be adequately analysed and understood and the investors' possibilities to be transparent need to be balanced with the authorities need for appropriate disclosure. With an appropriately transparent approach, also going forward the overwhelming majority of future Chinese investments into Germany will in our view still be able to proceed – as it should regularly be able to convince sellers, boards, their advisors and the ministry of the feasibility of the transaction.

For certain landmark deals which are subject to a high degree of political scrutiny and public discussions, the proposed amendment of the FIC regime will, however, likely provide for additional hurdles in the future. For such deals, the FIC procedure will become even more challenging and the obtainment of expert advice should be an indispensable part in the plans of any foreign investor in order to obtain as much deal-security as early in the process as possible.

Key contacts

Dr. Tilmann Becker
Counsel
Frankfurt
T +49 69 505029 310
M +49 151 1491 9830

Dr. Christian Cornett
Partner
Frankfurt
T +49 69 505029 309
M +49 172 660 9519