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Germany Tightens Regulations concerning Control on Foreign Investments

In July 2017, the German government adopted, in a surprise move, new regulations to control foreign investments in Germany. The government does not seek to broaden the scope of the existing rules, but merely intends to clarify these rules. At first glance, the new rules indeed provide for more clarity when government intervention can be expected. However, changes to the procedures for governmental reviews will lead to a significant increase in uncertainty for investors, not in sensitive sectors, but likely in many other branches of industry.

1. What are the most significant changes?

In the past, mandatory filings were required for some investments in the defense sector and in some other sectors that are considered highly sensitive. In all other cases, mandatory filings were not required, but the German government could intervene in transactions that would constitute a danger to German national security. Investors could submit a voluntary filing in order to obtain certainty at an early stage whether the government had concerns with respect to a particular transaction.

Under the new rules, investments in more business activities in the defense sector than before will be subject to mandatory filing requirements. In addition, a notification requirement has been introduced for investments in areas that are non-military but which are considered to be particularly sensitive. We expect that, in practice, investors will submit a voluntary filing instead of a mere notification, because a voluntary filing (which is slightly more substantial) will speed up the review process by authorities.

Another significant change is a procedural amendment for investments that are not subject to a filing or notification requirement: In the past, the government was barred from taking any action if it did not react within three months after signing. This applied even in cases where the government was not aware of the investment. This timeframe has now been extended to five years. This means: If an investor does not submit a filing or a notification to the German government, the investor will only have certainty that the government will not intervene in the investment five years after signing.

2. Which transactions are subject to the new regulations?

From the point of view of German controls on foreign investments, industries can now be divided into three groups: (1) activities which are highly sensitive and which are subject to a **mandatory filing** requirement; (2) activities which have been

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identified as particularly sensitive and which are subject to a **notification** requirement; and (3) all other activities. In principle, the German government can intervene in investments in all three of these groups. In practice, the government will generally not intervene in investments in the third group. In this respect, the new rules provide additional certainty to investors: German law now identifies, for the first time, those industry sectors which are in the focus of the government, while investors can trust that the government will generally not intervene in transactions in the other sectors.

Under the new rules, **mandatory filing** requirements apply for investments in companies which are active in the following types of activities:

- Development or manufacturing of war weapons or of engines or gears for tanks;
- Development or manufacturing of certain military items, mainly electronic equipment or special IT applications for military or defensive use;
- Manufacturing of IT systems that have been officially approved for handling classified government information; and
- Operation of high-quality satellite-based earth observation systems.

Notification requirements now apply for investments in companies which are active in the following types of activities:

- Activities related to “critical infrastructure”. “Critical infrastructure” in this sense does not only comprise the provision of basic necessities (e.g. energy, water and waste water, telecommunications, hospitals or food), but also, for example, payment systems or insurance services. Only significant and large-scale operations connected with these activities would be considered “critical infrastructure”;
- Development of software specially designed for the operation of “critical infrastructures”;
- Activities related to legal telecommunications interception activities;
- Provision of large-scale cloud computing services; and
- Companies which have been approved for the provision of components or services for the central IT system used by health professionals in Germany.

In addition, the government is entitled to intervene in transactions in any other industry sector if the transaction constitutes a danger to the national security of Germany. However, in practice, the government could only intervene in an investment in activities not listed above under very rare circumstances.

3. What is a „foreign investor“? Which thresholds are relevant?

For investments which are subject to **mandatory filing** requirements, a “foreign investor” is any investor not established in Germany. For investments in all other sectors (this includes investments in sectors which are subject to a **notification** requirement), a “foreign investor” is an investor who is not established in the EU or in the EEA or in Switzerland.

An investment will only be subject to German control on foreign investment rules if the foreign investor acquires at least 25 % of the voting rights in the German company.

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4. How are transactions reviewed by German authorities? Which timeframes apply?

Generally, a two-stage review process applies: First, the German Federal Ministry of Economics and Energy (“BMWi”) will carry out an initial review of a transaction. If BMWi decides that there could indeed be a danger to German national security, BMWi will initiate the second stage of the review. In this case, BMWi will notify the investor accordingly (and in most cases also the German target company). If BMWi then decides to adopt measures to restrict the transaction, these measures must be approved by the whole cabinet of ministers.

Mandatory filings and notifications must be submitted to BMWi only after signing. BMWi must conclude the first stage review within a period of three months after learning of the transaction. The timeframes for the second stage review – if initiated by BMWi – depend on the type of filing or notification submitted to BMWi.

In cases where a mandatory filing is not required (that means cases where only a **notification** is required or where no filing or notification is required at all), investors can speed up the review process by submitting a **voluntary filing** in the form of an application for a Certificate of No Objections (*Unbedenklichkeitsbescheinigung*). In that case, BMWi has only two months for the first stage review. If BMWi does not initiate the second stage review within this timeframe, the Certificate is deemed to have been granted.

If investors do not submit any filing or notification to BMWi at all, under the new rules they will only have certainty that the government will not intervene in the investment five years after signing. This is a very significant amendment: To date, the government was barred from intervening in investments if BMWi had not acted within three months after signing (even if BMWi never learned about the investment). As a result, we expect that investors will submit applications for Certificates of No Objections significantly more often than before to obtain certainty about their transactions.

5. Which measures may German authorities adopt?

If BMWi determines that a transaction poses a danger to German national security, BMWi may adopt measures to restrict the transaction. These measures may e.g. take the form of a limitation of the voting rights of the investor. BMWi may even prohibit a transaction. In extreme cases, BMWi is entitled to appoint a trustee to unwind a transaction (while the purchaser must bear the costs for the trustee). All measures taken to restrict a transaction must be approved by the whole cabinet of ministers.

6. Are there further developments relating to control on foreign investment that investors should be aware of?

In early 2017, the governments of Germany, France and Italy submitted a proposal to the European Commission to tighten the rules for controls of foreign investments also on the EU level. This initiative places particular emphasis on practices of foreign States that are considered unfair. Investment restrictions are suggested, for example, in cases where there are instructions by a foreign government to make certain investments abroad or where an investment is made possible by subsidies granted by a foreign government. In addition, the initiative refers to the principle of reciprocity: The German, French and Italian governments propose that foreign

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investors could also face restrictions if their home country provides for similar restrictions on foreign investment (such as, e.g. a requirement to establish joint ventures with a local partner).

As these measures would require far-reaching changes to legislation on the EU level, it remains to be seen if this initiative will be successful. In any event, these measures could only be implemented in the long run.

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