International Trade

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Germany's Foreign Direct Investment Regime: Further Changes Ahead

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Key Points

- On November 29, 2018, the German Minister for Economic Affairs, Peter Altmaier, presented its "National Industry Strategy 2030." Amongst other things, the strategy paper sets out the key points of the Minister's plans to expand the ability of the German government to screen and prohibit acquisitions of German companies by Non-EU investors under the German Foreign Trade Regulation (AWV). The Minister expects that the requisite amendments of the AWV will be enacted by October 2020.
- According to the strategy paper, the list of security-relevant acquisitions shall be extended; acquisitions of 10 percent or more shares in the sectors of artificial intelligence, robotics, semiconductors, biotechnologies and quantum technologies by Non-EU investors shall henceforth become subject to screening by the German Ministry of Economic Affairs and Energy (BMWi). In addition, it is expected that the requirements for the prohibition of an acquisition will be modified: While a prohibition under the AWV is currently only possible where an acquisition poses a threat to the public order or security of the Federal Republic of Germany, the next amendment of the AWV will likely introduce a foreseeable impairment test.
- The proposed revision of the AWV will also introduce a cooperation mechanism for the involvement of other EU Member States and the European Commission in the FDI screening procedure in order to comply with the EU FDI Screening Regulation of March 19, 2019.
- The strategy paper also proposes the introduction of a mechanism by which the Kreditanstalt für Wiederaufbau (KfW), a state owned development bank, shall, as ultima ratio, be given the ability to acquire shareholdings in sensitive or security relevant sectors where the German government is otherwise unable to prohibit or hinder an acquisition. The strategy paper does, however, not specify the mechanics of this so called "National Fallback Option".

Background

Over the last couple of years, policy-makers in Germany have increasingly started to take a critical look at acquisitions of German high-tech companies and critical

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infrastructure by Non-EU investors, in particular (state-backed) Chinese investors. As a result, the BMWi has started to exercise its screening rights under the AWV more extensively[1], and in August 2018, the German government, for the first time, decided to prohibit the acquisition of a German company by a Non-EU investor since the introduction of the foreign investment screening rules in 2004[2]. Moreover, the German government has repeatedly tightened the legal framework, in particular by expanding the definition of security-relevant sectors[3], and, most recently, by lowering the threshold for screening and prohibiting acquisitions of companies in certain sectors from 25 percent to 10 percent[4].

The ability of the BMWi to prohibit acquisitions by Non-EU investors has nonetheless remained fragmented. The much-discussed takeover of robotics manufacturer Kuka AG and the attempted takeover of chip manufacturer Aixtron SE by Chinese investors, have demonstrated that it is questionable whether the existing legal framework is broad enough in order to implement the BMWi's political agenda.

In parallel, the European Union's legal framework for the screening of foreign direct investments into the European Union (EU FDI Regulation), which will apply from October 11, 2020, has been enacted[5]. Amongst other things, the EU FDI Regulation sets out a list of critical technologies, which are likely to be relevant for security and public order, such as robotics, semiconductors and biotechnologies, and introduces a mechanism for the cooperation between EU Member States and the European Commission. The EU FDI Regulation will require technical amendments of the AWV, but more importantly, provides a roadmap to refine the list of security-relevant technologies.

Proposed Amendments

Refinement of Scope of Cross-Sectoral Screening

The Cross-Sectoral Screening of acquisitions, pursuant to Sections 55-59 AWV, contains a non-exhaustive catalogue of industry sectors where acquisitions by Non-EU investors can affect the public order or the security of the Federal Republic of Germany. The catalogue was most recently expanded in December 2018, when certain media enterprises were added to the list[6].

The implementation of the National Industry Strategy 2030 will likely expand the catalogue further by adding artificial intelligence, robotics, semiconductors, biotechnologies and quantum technologies as security relevant sectors. These technologies, which were expressly mentioned by Peter Altmaier in connection with the presentation of the strategy paper, are an extract from the technologies which are qualified as security-relevant by the EU FDI Regulation. The EU FDI Regulation's list of security relevant technologies is, however, more comprehensive and additionally includes, for example, aerospace and nanotechnologies. It remains to be seen whether these additional technologies will also find their way into a revised AWV. It is, however, likely that acquisitions in all listed technologies will be subject to a 10 percent threshold (instead of a 25 percent threshold).

According to press reports, Mr. Altmaier's plans to amend the AWV will also entail a modification of the relevant test for the prohibition of an acquisition. Under the existing rules on Cross-Sectoral Screening, the relevant test is whether an acquisition poses a "threat" to the public order or security of the Federal Republic of Germany. In the future, the relevant test would be whether there is a "foreseeable impairment" of the public order or security of the Federal Republic of Germany. This test is consistent with the terminology that is used in Article 4 of the German language version of the EU FDI Regulation. The term "foreseeable impairment" is more vague than the traditionally used and familiar term "threat." Its introduction should, therefore, on the one hand, considerably increase the German government's scope for a prohibition of acquisitions, but on the other hand, make the outcome of the screening procedure less predictable. The strategy paper does, however, not explicitly pick up this modification.

Mechanism for EU-wide Cooperation

Under the EU FDI Regulation, a EU member state shall notify the European Commission of any foreign direct investment in its territory that is undergoing screening. Another EU member state may provide comments to the EU member state undertaking the screening, in particular, if it considers that the foreign direct investment is likely to affect its security or public order. In addition, the European Commission may issue an opinion addressed to that member state undertaking the screening, e.g., when the screened transaction is likely to affect the security or public order of more than one member state. A similar mechanism applies to foreign direct investments that are not (yet) being screened. The comments by other member states and the opinion by the Commission are not binding for the addressed member state, but shall be given "due consideration" (or given "utmost account" if the Commission's opinion and the relevant foreign investment affects "projects or programs of Union interest").

According to the strategy paper, the AWV will have to be amended in order to make provision for the cooperation mechanism. The strategy paper does not specify the envisaged changes, but it is conceivable that the amendments to the AWV will mostly be of a technical and organizational nature. It may also result in an extension of the applicable screening periods.

"National Fallback Option" — Intervention by KfW

The strategy paper further proposes the implementation of a mechanism whereby KfW can acquire a shareholding in a German target company in order to prevent its acquisition by a Non-EU investor, so-called "national fallback option" (Nationale Rückgriffsoption) (Fallback Option). A similar concept, the establishment of a state fund that can acquire companies in exceptional circumstances, was considered by the BMWi in the past, but has previously not been substantiated.

According to the strategy paper, the Fallback Option shall apply if all other means of defense against an unwelcome foreign acquisition attempt (in particular private sector solutions[7] and the instruments under the AWV) are unavailable, and only in the case that sensitive or security-relevant technologies are affected. In order to be able to exercise the Fallback Option quickly and efficiently, the strategy paper suggests the introduction of a "standing committee" at government level, which will be able to render time critical decisions on the basis of a (yet to be defined) rulebook. The strategy paper does, however, not flesh out several important key aspects of the Fallback Option. It remains, for example, unclear whether the Fallback Option shall entail a (general) statutory pre-emption right of KfW, or whether KfW would simply be given the ability to make a competing bid in order to outbid an unwanted investor. Moreover, the scope of the Fallback Option remains unclear; the fact that it shall apply where the instruments under the AWV turn out to be insufficient indicates, however, that the

Fallback Option will not be tied to a substantiation of a threat or a foreseeable impairment of the public order or security of the Federal Republic of Germany and, potentially, apply irrespective of the size of the acquired shareholding. It also remains to be seen whether the Fallback Option will also cover situations in which a permitted prohibition of an acquisition would severely damage the interests of the target company.

While the implementation of the Ministry's proposals, with respect to the refinement of the Cross-Sectoral Screening, is, in principle, very likely, it remains questionable whether the Fallback Option will be implemented in connection with the upcoming revision of the AWV. Firstly, the Fallback Option faces fundamental opposition from industry associations. Secondly, substantial details of the Fallback Option, such as its funding, mechanics and scope, will have to be worked out and, moreover, coordinated with other ministries, including the Finance Ministry.

[1] E.g., recently, with respect to the proposed acquisition of Vossloh AG, a manufacturer of railway infrastructure, by a Chinese railway technology provider.

[2] Acquisition of Leifeld Metal Spinning AG by Chinese Yantai Taihai Corporation.

[3] Neunte Verordnung zur Änderung der Außenwirtschaftsverordnung of July 12, 2017, BAnz AT of 17 July 2017.

[4] Zwölfte Verordnung zur Änderung der Außenwirtschaftsverordnung of December 19, 2018, BAnz AT of December 28, 2018.

[5] Regulation (EU) 2019/452 of the European Parliament and of the Council of March 19, 2019 establishing a framework for the screening of foreign direct investments into the Union, Official Journal of the European Union, LI 79/1, 21/03/2019.

[6] See link to our alert of January 3, 2019

[7] E.g., the identification of a "white knight" that is willing to acquire the target company. The German government made an attempt to organize a private sector solution with respect to the acquisition of Kuka AG by Midea in 2016, which was, however, not successful.

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