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Guide to the German Foreign Direct Investment Control Regime

Foreign Direct Investment (FDI) control has seen a significant surge in recent years. Germany is no exception. While the German approach towards foreign investments has traditionally been liberal, the German legislator following the overall trend significantly tightened the German FDI regime. This applies not only to investments in specific, security sensitive areas such as military technology. Following the latest amendments of the German FDI regime more and more non-EU/EFTA investments in areas such as critical infrastructure (energy, telecommunications, information technology, etc.), cyber security, high technology, media, medical supplies etc. must be notified with the Federal Ministry for Economic Affairs and Climate Action (BMWK). According to the BMWK's statistics, in 2021 alone 306 transactions were notified with the BMWK compared to around only 40 transactions in 2016. A further increase is expected.

Since FDI control – in addition to merger control – has become a major factor in transaction management, this blogpost provides practical answers to the most pressing questions regarding the German FDI regime.

I. WHAT ARE THE RELEVANT LAWS IN GERMANY AND WHO IS IN CHARGE?

The German FDI control is governed by the Foreign Trade and Payments Act (AWG) and the Foreign Trade and Payments Ordinance (AWV). The BMWK is in charge of reviewing foreign investments that are caught by the control regime pursuant to the AWG and the AWV.

II. WHAT IS THE GENERAL SCOPE OF FDI CONTROL?

German FDI control has two areas, the cross-sectoral (Sec 55 AWV et seq.) and the sector-specific control (Sec 60 AWV et seq.):

- Under the cross-sectoral control, the BMWK may scrutinize every direct and indirect non-EU/EFTA investment of 25% (in certain business sectors 10%/20%) or more of the voting rights in a German company irrespective of the company's field of business.
- Under the sector-specific control, the BMWK can scrutinize any foreign, i.e., also EU/EFTA, direct or indirect investment of 10% or more of the voting rights in a German company with activities in specific, security sensitive areas (military technology, IT security products used for processing classified government information, etc.).

III. WHAT TYPES OF INVESTMENTS ARE CAUGHT BY THE FDI REGIME?

Beyond investments of 10%20%25% or more (see above), German FDI control may also apply to investments below the above-mentioned thresholds if the investor – in addition to certain minority voting rights below the

thresholds – is assigned, for instance, additional seats or majorities in supervisory bodies or the management or is granted veto rights in the case of strategic business or personnel decisions (Sec 56 (3), 60a (2) AWV).

Moreover, any further acquisition of voting rights – following an initial investment in the German company that already triggered FDI control – is also subject to review if it results in a total of 20%, 25%, 40%, 50% or 75% of the voting rights in the German company depending on the initial threshold applied (10%/20%/25%; sec 56 (2), 61 (2) AWV).

As regards the calculation of the thresholds, one should bear in mind that voting rights of third parties in the German company may be attributed to the investor if the investor, for instance, already holds a certain number of shares in the third company – not necessarily amounting to control over said company (Sec 56 (4)(5), 60a (2) AWV).

Finally, both the cross-sectoral and the sector-specific control capture not only share deals, but also asset deals. Accordingly, it may suffice to acquire certain assets of a German company to trigger the FDI control by the BMWK (Sec 55 (1a), 60 (1a) AWV).

IV. WHEN IS AN INVESTOR CONSIDERED "FOREIGN"?

As regards the cross-sectoral control any non-EU/EFTA investor is considered foreign. In the sector-specific control any non-German investor is considered foreign, i.e., also EU/EFTA investors.

However, both the cross-sectoral and sector-specific control also capture indirect investments in German companies. The BMWK also has the right to control non-foreign investments if there are indications that the specific structure of the acquisition, i.e., the use of a German or EU/EFTA investment vehicle, is employed to escape scrutiny under German FDI control (Sec 55 (2), 60 (2) AWV). Therefore, depending on the specifics of the case, the BMWK may "look through" the direct investor to assess whether a certain investment has to be considered foreign. A situation in which the BMWK regularly focuses on the natural or legal person behind the direct investor is where a German or EU shelf company is used as a transaction vehicle (e.g., for purposes of tax optimization).

V. WHEN IS A TARGET CONSIDERED "GERMAN"?

For a target company to be considered as German, it is sufficient to have a legal person based or headquartered in Germany. Under the notion of "indirect investment" it further suffices that the direct non-German target has a German subsidiary. Finally, a target may also be considered German if branches of foreign legal persons are headquartered in Germany or permanent establishments of foreign legal persons exist in Germany. Accordingly, transactions that appear to be foreign-to-foreign from the outside, may still be liable to be notified with the BMKW.

VI. ARE THERE ANY *DE-MINIMIS* EXCEPTIONS?

In contrast to merger control, elements like turnover or transaction value are not relevant for FDI control. Accordingly, German FDI law does not know *De-minimis* exceptions that would exclude investments in targets below a certain size from scrutiny. The BMWK's 2020 prohibition of Chinese Addisino's (a subsidiary of state-owned defense group China Aerospace Science and Industry Corp) plans to acquire German IMST GmbH, which is active in the field of satellite and radar communication, is a case in point. At the time of the prohibition IMST GmbH only had a worldwide turnover of EUR 14 million.

VII. IS IT MANDATORY TO SUBMIT AN APPLICATION...

Whether the submission of an application is mandatory or not depends on the type of investment.

... UNDER THE CROSS-SECTORAL CONTROL REGIME?

The cross-sectoral control regime allows the BMWK to scrutinize *ex officio* any direct or indirect acquisition of 25% or more of the voting rights in a German company by a non-EU/EFTA investor irrespective of the business sector involved.

However, the cross-sectoral control only provides for a mandatory application if the German company is active in certain fields of business, which are defined in Sec 55a (1) AWW. Depending on the field of business, a filing obligation arises if the investor acquires 10%/20% or more in the target company, e.g.:

- Acquisitions of 10% or more of the voting rights must be reported if the target company operates a critical infrastructure or develops or manufactures critical components for the respective infrastructure (e.g., energy, information technology and telecommunications, transport and traffic, health, water, food, finance, and insurance) or if it provides other particularly sensitive services (e.g., cloud-computing offers of a certain size or activities in the media industry) as defined in Sec 55a (1) no 1 to 7 AWW.
- Acquisitions of 20% or more of the voting rights must be reported if the business activities of the German company fall within the scope of the list provided in Sec 55a (1) no 8 to 27 AWW. The list captures activities in fields as diverse as medical devices, pharmaceuticals, autonomous driving, robotics, quantum technology, semiconductors, AI, or 3D printing.

... UNDER THE SECTOR-SPECIFIC CONTROL REGIME?

Under the sector-specific control regime any acquisition of 10% or more of the voting rights in a German company by a foreign investor (including EU/EFTA investors) is liable to be notified to the BMWK, if the German company is active in certain specific, security sensitive areas (military technology, IT security products used for processing classified government information, etc., Sec 60 AWW).

Since the recent amendments of the German FDI control, an application notification may already be triggered if only a small department of a company is active in one of the security sensitive areas, e.g., acts as supplier of goods to a military manufacturer, cf. Sec 60 (1) sentence 1 no 4 AWW.

VIII. IS IT POSSIBLE TO RECEIVE FORMAL CLEARANCE ALSO OUTSIDE THE MANDATORY NOTIFICATION OBLIGATIONS?

Investments which are not caught by the mandatory filing obligations under the cross-sectoral or sector-specific control regime (e.g., because the target has no relevant activities in any of the listed fields of business, Sec 55a (1) AWW), may generally be consummated without interference of the BMWK. Yet, as already pointed out, the BMWK may decide to investigate any investment of 25% or more of the voting rights by a non-EU/EFTA investor in a German company (irrespective of the company's field of business) up to five years after signing (Sec 14a (3) AWG).

To avoid the uncertainty of a potential *ex officio* investigation by the BMWK and achieve transaction security, the investor can in a situation, where no filing obligation exists, but the BMWK still has jurisdiction to investigate the transaction, apply for a certificate of non-objection (Sec 58 AWW). This approach is particularly sensible in situations where it is expected that the BMWK may be interested in the deal and might consider it to be a threat to public order or security (compare below IX.).

IX. WHAT IS THE SUBSTANTIVE LEGAL TEST APPLIED BY THE BMWK?

The substantive test applied by the BMWK differs, depending on whether the notification is filed under the cross-sectoral or sector-specific control regime.

- Under the cross-sectoral control, the BMWK can intervene if the acquisition is likely to have an effect on the public order or security of Germany, of another Member State of the European Union or in relation to projects or programs of Union interest within the meaning of Article 8 of Regulation (EU) 2019/452, Sec 55 (1) AWV).
- Under the sector-specific control, the BMWK can intervene if the acquisition is likely to impair essential security interests of Germany, Sec 60 AWV.

While interventions of the BMWK must respect the principle of proportionality, the BMWK has significant leeway with respect to (i) the decision of whether to intervene, (ii) the scrutiny and weighing of the acquirer's background, and (iii) potential measures (ranging from conditional approval to prohibition).

X. WHICH INTERVENTION POWERS DOES THE BMWK HAVE?

If the acquisition does not raise any concerns regarding the public order or security/essential security interests of, in particular, Germany, the BMWK clears the acquisition or issues a certificate of non-objection (Sec 58, 58a, 61 AWV).

If the BMWK, however, identifies concerns for the public order or security/essential security interests of, in particular, Germany, it can prohibit the direct acquirer from making the investment or issue instructions to the parties involved and the companies affiliated to them in order to protect essential security interests (Sec 59, 62 AWV).

XI. WHAT ARE THE DEADLINES FOR THE REVIEW BY THE BMWK?

The BMWK's review procedure is divided into two phases, the preliminary review (phase I) and the in-depth/formal review (phase II), Sec 14a (1) AWG. Most deals are dealt with and cleared in phase I. The BMWK only opens phase II if it has concerns regarding the envisaged investment.

In phase I, the BMWK has two months (usually starting with the notification/application for a certificate of non-objection) to decide whether to open a phase II in-depth investigation or whether to clear the transaction (Sec 14a (1)(3) AWG). Phase I may be extended with the consent of the parties involved (Sec 14a (5) AWG).

If the BMWK initiates a phase II assessment, it has additional four months (starting from the submission of all relevant information for the BMWK's assessment) to reach a decision. Should the transaction be particularly complex, the deadline may be extended by a further three months, and, if the acquisition affects the defense interests of Germany, by another month (Sec 14a (4) AWG). In addition, phase II may also be extended at any time with the consent of the parties (Sec 14a (5) AWG). Beyond the various extensions, the deadlines for phase II are suspended if the BMWK requests additional information from the parties or negotiates contractual arrangements with them (Sec 14a (6) AWG).

If the BMWK fails to reach a decision within the time frame provided for in phases I or II, the acquisition is deemed to have been cleared. In 2021, of the 306 cases assessed by the BMWK, 266 were cleared within phase I, while 40 cases were subject to a considerably longer phase II review. Of these 40 cases, 6 cases saw interventions from the BMWK (i.e., prohibitions, side conditions, public-law contracts and/or administrative orders). In 2019 and 2020, the BMWK intervened in 12 cases out of 160 (2020)/106 (2019). In general,

the fact that the BMWK does not publish its decisions makes it extremely difficult to predict the outcome of a critical case.

XII. WHAT ARE THE CONSEQUENCES IF A MANDATORY APPLICATION HAS NOT BEEN SUBMITTED?

In transactions that are subject to a notification obligation, the underlying contractual agreements are valid but subject to dissolution if the BMWK issues a prohibition decision (condition subsequent, Sec 15 (2) AWG). If the BMWK does not clear the transaction, the contracts are invalid from the beginning (*ex tunc*).

To prevent the unlawful implementation of acquisitions, the German FDI control regime also prohibits certain forms of consummation. The German FDI rules specifically prohibit the exercise of voting rights by the investor and the disclosure of company-related, security relevant information (Sec 15 (4) AWG). Any acts in violation of these gun-jumping rules are null and void pending clearance. Intentional violations of these prohibitions are criminal offenses by the individuals involved and punishable by imprisonment of up to five years or a fine (Sec 18 (2) no 8 AWG). In the case of negligence, the violation is punishable by a fine of up to EUR 500,000 (Sec 19 (1) no 2 AWG).

Where no notification obligation exists, the parties are free to consummate the transaction. Yet, in situations where the parties expect the BMWK to take a critical stance towards the deal, it may be advisable to apply for a non-objection certificate and only close the deal after obtaining the BMWK approval.

XIII. CAN DECISIONS OF THE BMWK BE APPEALED?

The Administrative Court of Berlin is competent for appeals against decisions of the BMWK. Since the BMWK has a significant discretion, its decisions are, however, rarely appealed.

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