

Major reform of Foreign Direct Investment rules in Germany

April 30, 2021

The long-awaited 17th amendment of the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung - AWW*) has now come. It will enter into force on May 1, 2021.

After three amendments of the German FDI control regime in 2020, Germany now tightens its FDI control regime once again. The new changes further implement the Regulation (EU) 2019/452 of March 19, 2019 (EU FDI Screening Regulation), specially targeting “critical technologies” such as artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense and many others. Mandatory FDI notification is now required for foreign investment in these tech-related targets. The new rules will definitely have a strong impact on future foreign investments and M&A activity in Germany. The good news is that Germany tries to balance (at least to certain extent) national security interests against an open and investor-friendly environment.

The amendment includes a transitional provision so that the new FDI rules will only apply to transactions that are signed on May 1, 2021 or afterwards. In the case of an offer within the meaning of the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz - WpÜG*), the relevant date is the date of publication of the decision to make the offer.

Key features of the reform

1. Sixteen new sectors/groups subject to mandatory notification within the cross-sectoral FDI review – 20% initial threshold

In addition to the sectors with critical infrastructure (e.g. energy, IT and telecommunication, food, transport) and to the specific healthcare related cases added due to the COVID-19 pandemic (e.g. specific PPE, essential medicines) in 2020 the **mandatory notification requirement under the FDI cross-sectoral review has now been extended to sixteen additional sectors/groups**. This massive extension will mainly affect tech-related investments as it very much focusses on “critical technologies”. This includes 3D printing technology products, quantum technology products, products for data grids (e.g. 5G), autonomous cars or drones or related components and many other cutting-edge technologies and products. However, it is important to note that the **amendment contains quite detailed descriptions of concrete technologies and products instead of listing whole industries** or simply referring to the EU Dual Use Regulation (Council Regulation (EC) No 428/2009). Good examples for the effort to define the scope of application as precisely as possible are the case groups on robotics and artificial intelligence, that set out very specifically which parts of these technologies are covered, such as robots built for handling highly explosive substances and AI for surveillance systems. The same applies to the categories on aviation / space and on nuclear technology that refer to individual items of Annex I to the EU Dual Use Regulation.

Another important point is that – unlike in the draft amendment bill of January 2021 – **the mandatory notification**

requirement for these sixteen new sectors/groups is only triggered above the threshold of 20% voting rights (and not 10% as it was stipulated in the draft bill). In addition, the same threshold of 20% will now also apply for all four specific healthcare related case groups added due to the COVID-19 pandemic last summer. Start-ups and financial investors may hopefully benefit from this extended threshold.

2. Broader scope of sector-specific FDI review

As of now, new mandatory notification requirements are also implemented within the sector-specific FDI review. The scope is much broader than before as it covers **all kinds of listed military equipment**, defence products covered by secret patents, encryption-technology products, or infrastructure deemed essential for Germany's defence. "**Probable impairment**" of Germany's essential security interests (instead of a concrete threat) will be the new FDI sector-specific review scale. This has been aligned with the FDI cross-sectoral FDI review scale that was lowered to a "probable impairment" of public order or security in 2020.

3. Subsequent acquisition of voting rights – new thresholds

Although the amendment clarifies that the subsequent acquisition of voting rights in a sensitive target is again subject to mandatory FDI notification there is also some positive news about it. Unlike the draft amendment bill from January 2021, the renewed mandatory notification **is not triggered by every single additional acquisition of voting rights even if this is only 1%**. Instead, the renewed notification requirement will be limited to certain thresholds that are relevant under Corporate Law. These are:

- **20%, 25%, 40%, 50% or 75%** for the sectors/groups subject to initial mandatory notification at 10% voting rights (e.g. critical infrastructure, cloud computing services, media companies, defence related targets);
- **25%, 40%, 50% or 75%** for the sectors/groups subject to initial mandatory notification at **20%** voting rights (the COVID-19 pandemic related healthcare sectors and the new tech-related sectors); and
- **40%, 50% or 75%** for all other transactions in the scope of German FDI rules (initial threshold at **25%** voting rights).

4. Atypical acquisition of control

For the first time the German FDI control regime now includes not only the acquisition of voting rights but also atypical acquisition of control. The latter can be investor agreements or shareholder agreements that provide the foreign investor with a disproportionate weight compared to its actual voting rights share and therefore influence comparable to a higher voting rights share. The amended FDI rules explicitly name **the assurance of additional seats or majorities** in supervisory bodies or in the management, **the granting of veto rights** in strategic business or personnel decisions and the granting of certain information rights where this position (potentially together with real voting rights) correspond to a share of voting rights that triggers an FDI review. However, although these cases now fall under the scope of an FDI review in Germany, there is **no mandatory notification requirement for them**.

Impact on M&A transactions / Outlook

The 17th amendment to the AWW is set to greatly increase the number of acquisitions by foreign investors to be notified to the Federal Ministry for Economic Affairs and Energy (BMWi) and thus have a very strong impact on FDI transactions as well as on M&A activities, in particular in tech-related targets. This also means that these foreign investments that are subject to notification requirements are suspended for the duration of the FDI review. In addition, criminal sanctions are applicable if the prohibition of execution of the acquisition contract is deliberately violated. The German Government emphasizes, however, that this is still an amendment with a sense of proportion. It is indeed true that Germany tries to limit the scope of the "critical technologies" to particularly sensitive technologies and products

without just referring to blanket terms as e.g. nanotechnology, AI or space. Another “relief” for tech-related and other sensitive targets and their foreign investors is the raising of the first threshold relevant for mandatory notification from 10% to 20% and the implementation of thresholds for the subsequent acquisition of additional voting rights.

The new amendment is a part of an EU-wide process of introducing stricter FDI screening rules that are much broader in scope. Many EU governments increasingly pay attention to potential risks for public security and safety or public order associated with foreign investments. The COVID-19 pandemic has accelerated the process of implementing FDI control regimes. Since October 11, 2020, the EU FDI Screening Regulation has been in force. FDI reviews take place in an EU-wide cooperation procedure. This is set to make transactions more complex and have a larger number of involved authorities as the EU Commission and EU Member States are now able to participate in the process. In the face of this legal framework, all parties involved in FDI transactions will have to be prepared for a longer and much more complex FDI screening process and proceed with due diligence.

We will continue to monitor the reform process of the German FDI rules and will keep you posted. If you have any questions regarding this alert or about regulatory matters in Germany, please contact Dr. Maria Brakalova (Competition, Antitrust and Regulatory, Berlin), Dr. Julia Pfeil (Public Policy and Regulatory, Frankfurt) or Andreas Haak (Competition, Antitrust and Regulatory, Düsseldorf).

For more information on FDI regimes around the world, see the Dentons Foreign Direct Investment (FDI) Global Tracker.

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