Investment Screening in Germany

and

Practical Implications of the New Legal Framework for Foreign Direct Investment in the European Union

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Abstract

*German investment control is regulated by the Foreign Trade and Payments Act (“**AWG**”) and the Foreign Trade and Payments Ordinance (“**AWV**”). In the last three years, German investment control has been the subject of several reforms, in the course of which the German government substantially tightened the applicable regulatory framework for the review of foreign investment by significantly extending the investment sectors subject to review and by lowering the relevant thresholds triggering the screening mechanism.*

The reforms undertaken have a serious impact on the practice of international investments in connection with German companies. Therefore, a detailed analysis of investment control law risks will become more important than ever for foreign investors in order to avoid execution obstacles, unexpected delays and even criminal sanctions for violations of the execution prohibition. This also applies to ongoing transactions that have not yet been consummated at the time the relevant legislative amendments come into force and therefore fall under the new, stricter rules. Overall, international investors need to be aware of the increasing hurdles for direct and indirect acquisitions of German companies.

*Furthermore, in March 2018, following an initiative of Germany, France and Italy, the Council of the European Union (“**EU**”) approved a Regulation on establishing a framework for screening of foreign direct investments (“**FDI**”) into the European Union (“**Regulation**”). The new Regulation became effective in October 2020. The Regulation creates an enabling framework for Member States to screen foreign direct investments on grounds of security and public order**.** The lack of any minimum threshold grants the European Commission and other Member States wide authority to directly interfere in the screening process of FDI in a specific Member State. The Regulation in conjunction with the current amendments of relevant national laws in major European economies further enlarges legal policy protectionism towards FDI.*

For this reason, this publication demonstrates and analyzes the current foreign investment control regime in Germany and explains the practical implications of the new legal framework for FDI in the EU. In particular, the strong tendency towards a stricter approach regarding the screening of foreign investment and the legal implications thereof will be outlined. It will be shown, that foreign investment screening in Germany and the EU has become a serious public policy instrument to safeguard national economic interests.

A. Introduction

Mechanisms on screening of FDI differ from country to country, both in substance and procedure. Traditionally, countries of the EU, in particular Germany, provide relatively open investment regimes to foreign investors. However, in the aftermath of controversially discussed company takeovers and acquisitions of major European enterprises, in particular, by Chinese state-owned enterprises, a growing concern in Germany regarding foreign investment by non-EU investors is indisputable. Therefore, the mechanisms on foreign investment screening have become an increasingly relevant issue in cross-border transactions that require an in-depth legal risk assessment and management prior to concluding the transaction. This is particularly underscored by the latest amendments of the applicable laws in Germany resulting in much stricter and more comprehensive foreign investment control regimes, substantially expending the right of the competent authorities to monitor and restrict foreign investments.

The structure and scope of investment review provided for under the AWG in conjunction with the AWV is that the Federal Ministry of Economics (the "**Ministry**"), the competent German authority, possesses an extensive ex-post examination competence regarding the acquisition of shares of German companies by third-country nationals. Of particular importance for FDI is the screening of sector specific and cross-sectoral investments by third-country nationals.

In this regard, the German legislator has lowered the threshold for the screening of FDI to the acquisition of 10 per cent of the voting rights of a German company being active in the military and encryption sector and of German companies which are operating in the field of critical infrastructure. Critical infrastructure currently includes facilities and systems in the energy, water, food, telecommunications, transport, financial, insurance and healthcare sectors.

Furthermore, the 15th AWV amendment which became effective in June 2020 is primarily related to the consequences of the COVID 19 pandemic and stipulates further state control of foreign investments in such German target companies that are active in the health care and infection control sectors. To this end, acquisitions of these companies must be reported to the Ministry. This also applies to share acquisitions above a participation threshold of 10 per cent. In this context, it cannot be ruled out that the Ministry will also further tighten its administrative practice in this regard and could make greater use of its powers to restrict and prohibit in the areas of public health and infection control.

In general, the reforms undertaken will have a serious impact on the practice of international investments in connection with German target companies. Therefore, a detailed analysis of investment control law risks will become more important than ever for foreign investors in order to avoid execution obstacles, unexpected delays and even criminal sanctions for violations of the execution prohibition. This also applies to ongoing transactions that have not yet been consummated at the time the relevant legislative amendments come into force and therefore fall under the new, stricter rules. Overall, international investors need to be aware of the increasing hurdles for direct and indirect acquisitions of German target companies.

These national developments must, additionally, be seen in the context of the adoption of the regulation on establishing a framework for the screening of foreign direct investment into the European Union (Regulation 2019/452) in March 2019 by the European Council and the European Parliament setting out imperative minimum requirements which must be common to member states' screening mechanisms.[1]

The main purpose of this publication is to analyze the substantive structure and procedural rules of regulations on foreign direct investment in Germany.

To this purpose this publication first introduces the relevant legal basis and general government's policies and practice with regard to the screening of foreign investment. It then focuses on analyzing the scope of application, the types of investments caught by the German foreign investment control regime, the jurisdictional thresholds triggering the review, the

[1] To ensure Germany's full participation in the new EU-wide cooperation mechanism the Federal Cabinet adopted the Sixteenth Ordinance Amending the AWV on 7 October 2020. It was published in the Federal Gazette on 28 October 2020 and entered into force on 29 October 2020. The legal situation - already amended by the first amendment to the AWG in accordance with the EU Screening Regulation - is thus implemented in the ordinance. In future, the investment screening programme will also include probable impairments of public order or security of other EU Member States and with regard to certain projects and programmes of Union interest.

substantive test for clearance, the concrete scrutiny procedure, and the right of recourse against decisions of the Ministry.

The final part of this publication illustrates the key features of the Regulation and discusses potential implications on the national investment screening regimes.

B. Investment Screening in Germany

In general, Germany is seeking to provide an open and positive investment climate to foreign investors. According to the UNCTAD World Investment Prospects Survey Germany is the most attractive business location in continental Europe.[2]

German legal, regulatory, and accounting systems are transparent and consistent with the international standard; foreign and domestic investors are treated equally when it comes to investment incentives, and the establishment and protection of property, both real and intellectual. Foreign investors can fully rely on the legal system, which is efficient and sophisticated.[3]

Furthermore, Germany maintains the largest and one of the most efficient networks of bilateral investment treaties in the world.[4]

However, in the light of acquisitions of German enterprises by Chinese state-owned companies the German government has adopted a stricter approach towards its foreign investment control regime.[5]

The legal basis for the review of foreign direct investments in Germany is provided within the German Foreign Trade and Payments Act ("*Außenwirtschaftsgesetz*", AWG) and the German Foreign Trade and Payments Ordinance ("*Außenwirtschaftsverordnung*", AWV). Furthermore, the procedure regarding foreign investment review and control is regulated in the Administrative Procedure Act ("*Verwaltungsverfahrensgesetz*", VwVfG). The permissible remedies against impairing investment control measures and decisions are regulated in the Code of Administrative Court Procedure ("*Verwaltungsgerichtsordnung*", VwGO).

The structure and scope of investment review provided for under the AWG in conjunction with the AWV is that the Ministry being the competent German authority, possesses an extensive ex-post examination competence regarding the acquisition of shares (share deal) of German companies as well as with regard to the acquisition of an enterprise in terms of an asset deal by third-country nationals. Of particular importance for foreign direct investments is the screening of cross-sectoral investments pursuant to Sec. 55 et seq. AWV and sector-specific investments pursuant to Sec. 60 et seq. AWV.[6]

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[2] Cf. UNCTAD (2018), p. 20.
[3] U.S. Department of State (2018).
[4] Cf. Stompfe (2017), p. 228.
[5] Cf. Reinhard/Pelster (2009), p. 444; Hasselbach/Peters (2017), pp. 1348 et seq.; *Flaßhoff/Glasmacher* (2017), p. 489; Seibt/Kulenkamp (2017), p. 1355; BDI (2019), Investitionskontrollen in Deutschland und Europa; Handelsblatt (2018), Kuka wird zum Testfall für chinesische Investoren in Deutschland.
[6] From the standpoint of legal doctrine, it must be considered that the provisions on sector-specific review pursuant to Sec. 60 et seq. AWV take precedence over Sec. 55 et seq. AWV. This is of particular importance with regards

On 19 December 2018, the German government has passed significant amendments to the AWV, inter alia, lowering the threshold for the screening of FDI to the acquisition of 10% of the voting rights of a German company being active in the military and encryption sector and of German companies which are operating in the field of critical infrastructure.[7] For the definition of the term "critical infrastructure", Sec. 55(1) AWV explicitly refers to the Act on the Federal Office for Information Security ("*Gesetz über das Bundesamt für Sicherheit in der Informationstechnik*"). Critical infrastructure is comprehensively defined in the Regulation on the Definition of Critical Infrastructure.

The 15th AWV amendment, which came into force in June 2020, marked the beginning of a series of legislative changes that tightened the rules for controlling foreign investments in Germany and expanded the scope of investment control. Triggered by the current COVID 19 pandemic, but also driven by fears of future comparable crisis situations, the Federal Government has come to the conclusion that cross-sectoral investment control in its current form is not sufficient to ensure the maintenance of a functioning healthcare system in Germany in the long term. The 15th AVW amendment therefore expands the group of reportable acquisitions with the aim of covering a broad spectrum of foreign investments in German target companies active in the field of healthcare and infection control. The focus of the amendment is clearly on the health sector. Thus, vaccine and antibiotic manufacturers, manufacturers of medical protective equipment and manufacturers of medical goods for the treatment of highly contagious diseases are included in the list of particularly safety-relevant companies.

Furthermore, on 8 April 2020, the Federal Government passed the draft amendment to the AWG. The amendment was published in the Federal Law Gazette on 16 July 2020 and entered into force on 17 July 2020. Specifically, the amendment affects the AWG in three core areas:

- The Ministry's competence of review is substantially extended. Foreign investments in the area of cross-sectoral investment review can already be restricted and prohibited if, as a result of the acquisition, the public order or security of the Federal Republic of Germany or another member state is "<u>likely to be impaired</u>". Previously, an "<u>actual threat</u> to public order or the security of the Federal Republic of Germany" was required. In addition, not only national interests but also interests of other EU member states are to be included in the assessment. In consequence this means that security concerns of the EU and other member states may play an essential role in the context of a German review procedure.

- All transactions that are subject to the notification requirement in Germany are to be considered as pendingly invalid (*schwebend unwirksam*) until they are cleared. Previously, only so-called sector-specific transactions, especially in the armaments sector, were subject to such an obligation, while for all other sectors the merger was completed even while it was being reviewed by the Ministry. In the case of

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to the reporting obligations, the civil law effects of the investment review and the procedural deadlines. In addition, the legislative intention of a possible prohibition of the relevant investment differs. While the sector-specific investment review serves to protect essential security interests and the foreign relations of the Federal Republic of Germany as well as to protect the peaceful coexistence of nations (Sec. 4(1) no. 1-3 AWG), the cross-sectoral investment review is intended to guarantee the protection of public order or security (Sec. 4(1) no. 4 AWG); cf. Müller/Hempel (2009), p. 1638.

[7] These changes may be regarded as incompatible with EU law, cf. Stompfe (2019).

intentional infringement, there is the threat of imprisonment for up to five years; in the case of negligence, there is at least the threat of a substantial fine. Sellers are not allowed to give purchasers the opportunity to influence the target company before the transaction has been approved by the Ministry. Therefore, in the sales agreement the completion of the transaction must be made subject to the condition precedent of final approval by the Ministry.

- The procedural deadlines have been comprehensively regulated. Previously, the duration of the review procedure was unpredictable, due to the fact, that the review period began anew with each request for information. Now a period of two months applies to the preliminary proceedings. When the actual review procedure is officially opened, four months are added, and in complex cases an extension of up to eight months is possible.

I. Cross-Sectoral Review[8]

The review of cross-sectoral investments pursuant to Sec. 55 et seq. AWV (sector-independent investment control) grants the Ministry the authority to prohibit the acquisition of domestic companies or shares/participations in such companies by non-EU nationals in certain cases or to flank such acquisitions with specific orders. The constitutive feature in this regard is that such measures must be indispensable in order to guarantee public order or security in the Federal Republic of Germany and of other EU member states.

1) Scope of Application

The prerequisites for the Ministry's competence to review foreign investments are stipulated in Sec. 55(1) AWV.

The Ministry's right to review and the Ministry's right to prohibit or restrict foreign investments requires that a domestic target company ("*inländisches Unternehmen*")[9] is acquired directly or indirectly by a foreign investor in whole or in part based on a certain legal transaction[10] ("*Rechtsgeschäft*"). It should be noted that the acquisition of a domestic company by a EU resident (European investor) meaning, inter alia, natural persons resident or habitually resident in the EU and legal persons or partnerships based or headquartered in the EU[11],in which a foreigner holds at least 10% or 25% of the direct or indirect share of voting rights can also be subject to the Ministry's review procedure, if the company is deemed to be particularly relevant under public order or security aspects.[12] A restriction of the acquisition additionally required a genuine and sufficiently serious threat to public order and security resulting directly out of the

[8] The following comments are based on an earlier publication by the author, Stompfe, YSEC Yearbook of Socio-Economic Constitutions 2020, pp. 1 et seq.
[9] Hereinafter referred to as "target company" or "domestic company".
[10] Legal transaction within the meaning of an acquisition transaction ("*Erwerbsgeschäft*") in the sense of an acquisition of a company or an acquisition of stock.
[11] Cf. Sec. 2(18) AWG.
[12] Cf. BT-Drs. 16/10730, p. 14; Krolop (2008), p. 41; Seibt/Wollenschläger (2009), p. 839.

acquisition transaction.[13] Due to the new legal situation, foreign investments in the area of cross-sectoral investment review can already be prohibited or restricted if, as a result of the acquisition, the public order or security of the Federal Republic of Germany or another member state is "likely to be impaired".

Object of Acquisition: "Domestic Company"

Investment screening pursuant to Sec. 55 et seq. AWV is only permissible if a domestic company is the objective of the transaction.

Definition of "Domestic"

The term "domestic" is legally defined in Sec. 2(15) AWG.

In this regard, domestic shall mean (i) natural persons resident or habitually resident in Germany; (ii) legal persons and partnerships based or headquartered in Germany, (iii) branches of foreign legal persons or partnerships if the headquarters of the branch are in Germany and separate accounts are kept for them; and (iv) permanent establishments of foreign legal persons or partnerships in Germany if the permanent establishments are administered in Germany.

Whereas the seat of a legal person or partnership is governed by commercial law[14], the "place of management" is determined by the place where the management actually takes the relevant decisions.[15] Therefore, foreign companies with registered offices in other countries and administrative headquarters in Germany are also covered by the definition of domestic.[16, 17]

Definition of "Company"

There is no legal definition of the term "company". It includes all legal entities (stock companies, limited liability companies, and associations) and partnerships as well as natural persons, provided that they are sole traders and can be identified on the market as an organised entity.[18] It has to be considered, that the legal form and the capital market capability of the target company are irrelevant factors for the Ministry's right to review under German public law.[19]

In order to avoid corporate loopholes, the takeover of parts of a company within the scope of a spin-off in accordance with the German Transformation Act (*Umwandlungsgesetz*", UmwG) or through the takeover of associated operating resources ("*dazugehörige Betriebsmittel*") are also

[13] BT-Drs. 16/10730, p. 15.
[14] Mausch-Liotta (2017), § 55, para. 13
[15] Mausch-Liotta (2017), § 55, para. 13.
[16] Seibt/Wollenschläger (2009), p. 835.
[17] For a German limited liability company (GmbH) this means that a GmbH which relocates its administrative headquarters abroad, but still maintains its registered office within Germany also qualifies as domestic, see Sec. 4a of the German Limited Liability Companies Act ("*Gesetz betreffend die Gesellschaften mit beschränkter Haftung"*, GmbHG).
[18] Pottmeyer (2018), §§ 55-59, para. 12. See with regards to the GmbH Hasselbrink (2010), p. 513.
[19] Seibt/Wollenschläger (2009), p. 835.

to be qualified as the “acquisition of a domestic company” within the meaning of Sec. 55(1) AWV.[20]

Furthermore, it must be considered that the Ministry’s right to review and restrict does not require the target company to belong to a certain economic sector.[21] Therefore, the Ministry’s right to review and restrict *a priori* encompasses all economic sectors.

Foreign Investor

The scope of cross-sectoral investment review, in principle, includes any investor who is neither residing in the European Union nor in any member state of the European Free Trade Association[22] (EFTA).[23]

In the case of natural persons, the domicile or usual place of residence is decisive for the determination of “residency” (“*Ansässigkeit*”); in the case of legal entities or partnerships, the statutory seat or place of management is decisive.

It is particularly important for private equity investors that investors residing on the Channel Islands (Jersey, Sark, Guernsey, Alderney, Herm) and the Isle of Man are exempted from investment control under foreign trade law, as the Channel Islands are part of the customs territory under European law and are therefore part of the community territory as defined in the AWG.[24, 25]

Parallel Application on State and Private Investors

It must be emphasized, that the Ministry’s right to review applies to both, state and private investors.

This is remarkable, especially since the political argumentation and justification in the public discussion regarding the numerous changes to the AWG and AWV and the associated stricter investment control regulations have always been driven by the concern of uncontrolled takeovers of German companies by foreign state companies, in particular by Chinese state and hedge funds.

In this regard, it must be highlighted, that the personnel scope of the cross-sectoral investment control is by no means limited to foreign state and hedge funds, but also affects private and institutional investors. The legal status of the foreign investor is also irrelevant.

[20] Söhner (2011), pp. 461 et seq.; Seibt/Wollenschläger (2009), p. 836; Mausch-Liotta (2017), § 55, para. 14.
[21] Mausch-Liotta (2017), § 55, para. 15.
[22] The EFTA member states are Iceland, Norway, Liechtenstein and Switzerland.
[23] The legal definition of a non-member of the EU in Sec. 2(19) AWG is a negative definition: all natural persons, legal entities and partnerships that are not residents of the EU in accordance with § 2 para. 18 AWG are to be qualified as a non-member of the EU.
[24] Sec. 2(8) AWG; cf. Voland (2009), p. 520; Seibt/Wollenschläger (2009), p. 835; Pottmeyer (2018), §§ 55-59, para. 19.
[25] To the contrary, the Cayman Islands, British Virgin Islands and Bermuda and the other overseas countries and territories listed in Annex II to the Treaty of Lisbon are outside the customs territory of the Community and are therefore not counted as Community territory within the meaning of the AWG, Seibt/Wollenschläger (2009), p. 835; Pottmeyer (2018), §§ 55-59, para. 19.

Therefore, the final legal codification of the definition and scope of the "foreign investor" goes far beyond the original political intention.

Prevention of Misuse and Circumvention pursuant to Sec. 55(2) AWV

The German legislator puts particular importance on the legal capturing of abuse and circumvention constellations.[26, 27]

Pursuant to Sec. 55(2)(1) AWV, acquisitions of domestic companies by residents of the European Union are also subject to investment control pursuant to Sec. 55(1) AWV if there are indications that an abusive approach or circumvention transaction has been undertaken in order to avoid or undermine an examination pursuant to Sec. 55(1) AWV.

It should be emphasised that this provision does not limit the power of review to constellations in which a foreign investor holds at least 10% or 25% of the direct or indirect share of voting rights "*Stimmrechte*") of the enterprise directly acquiring the domestic company. Thus, the right to review also exists if the direct acquirer ("*unmittelbarer Erwerber*") could only be indirectly influenced by foreign investors, e.g. through the interposition of another company.[28]

Indications of an abusive approach within the meaning of Sec. 55(2)(1) AWV shall in particular include cases where the direct acquirer does not maintain any business operations of its own other than the acquisition pursuant to Sec. 55(1) AWV or does not have any permanent establishment of its own including offices, staff and equipment within the European Union.[29]

Unlike the determination of the residency of the target company, branches and permanent establishments of the non-EU acquirer are not considered to be EU residents ("*unionsansässig*").[30] The overriding goal of this limitation of the definition of the term "community residence" according to Sec. 2(18) AWG and Sec. 2(19) AWG is to constitute a comprehensive right for the Ministry to examine and restrict investments conducted by these corporate forms. In this constellation, only the parent company is relevant for the determination of the nationality.[31] The parent company is only to be considered as residing within the EU if its registered office and head office are located in the European Union.[32]

Furthermore, the anti-circumvention provision of Sec. 55(2) AWV also applies to purchasers from EFTA states. In this constellation it must be examined if the direct acquirer from the EFTA States will arrange for a foreign acquirer from outside the EFTA states to acquire a shareholding that is relevant within the meaning of Sec. 56 AWV.

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[26] Cf. BT-Drs. 16/11898, p. 12; Thoms (2018), p. 107; Hindelang/Hagemeyer (2017), p. 884; Walter (2017), p. 653.

[27] In this context, difficulties arise in particular where, for example, a Dutch subsidiary of a non-EU company is acting as an intermediary. It should be noted, however, that a prohibition power only exists to the extent that an abusive structure can be identified. In particular, the involvement or participation of Special Purpose Vehicles can constitute a violation. It is characteristic that these SPVs have no corporate assets other than their share capital and therefore have no commercial justification, Hasselbrink (2010), pp. 513-514; Rosenberg/Hilf/Kleppe (2009), p. 832.

[28] Mausch-Liotta (2017), § 55, para. 33.

[29] Sec. 55(2)(2) AWV.

[30] Sec. 55(2)(3) AWV.

[31] Mausch-Liotta (2017), § 55, para. 35.

[32] Sec. 2(18) No. 2 AWV.

Acquisition Transaction ("*Erwerbsgeschäft*")

First, it shall be highlighted that the target company must be "acquired". With regards to the relevant acquisition transaction, the AWV distinguishes between the acquisition of a company ("*Unternehmenserwerb*") and the acquisition of shareholdings ("*Beteiligungserwerb*").

Company Acquisition

The acquisition of a domestic company only covers the acquisition of an entire enterprise meaning not less than 100% of the shares of that particular enterprise.[33] It is legally irrelevant if the acquisition is a public takeover according to Securities Acquisition and Takeover Act ("*Wertpapier- und Übernahmegesetz*", WpÜG) or any other company acquisition.[34]

Furthermore, the applicable provisions on investment screening apply to share deals and asset deals alike.[35] Additionally, the acquisition of a company after a spin-off ("*Abspaltung*") within the meaning of the UmwG or the operating material ("*Betriebsmittel*") of a separable business unit also falls under the term "company acquisition" within the meaning of Sec. 55(1) AWV.[36]

Acquisition of Shareholding

In addition, the acquisition of direct and indirect shareholding in a domestic company by a foreign investor is covered by the Ministry's authority to review foreign investments.

The direct shareholding comprises the direct acquisition of shares by the foreign investor in a domestic company. The acquisition of an indirect shareholding comprises on the one hand the constellation in which the foreign investor acquires a direct stake in a foreign company residing in the EU which already has a shareholding in a domestic company.[37] On the other hand, the acquisition of an indirect shareholding covers the constellation in which a company based in the EU or EFTA acquires a domestic company or shareholdings in this company and has itself a foreign majority shareholder.[38] In the later constellation, the acquisition conducted by the foreign majority shareholder only takes place indirectly.

Acquisition Threshold

[33] Pottmeyer (2018), §§ 55-59, para. 13.
[34] Seibt/Wollenschläger (2009), p. 836; Rosenberg/Hilf/Kleppe (2009), p. 832.
[35] Hasselbrink (2010), p. 514; Söhner (2011), p. 460.
[36] Mausch-Liotta (2017), § 55, para. 22; Pottmeyer (2018), §§ 55-59, para. 13; Hasselbrink (2010), p. 514.
[37] BT-Drs. 16/10730, p. 13; Mausch-Liotta (2017), § 55, paras 18 et seq.
[38] Mausch-Liotta (2017), § 55, para. 20.

In principle, all acquisitions of direct and indirect shareholding by which investors domiciled outside of the EU or the EFTA region acquire at least 25% of the voting rights in a domestic company can be subject to examination.

However, as the result of the latest AWV amendments the examination of foreign investments is already possible with an acquisition of at least 10% of the voting rights, if the domestic company is operating in the field of critical infrastructure or provides other particularly security-related services as defined in Sec. 55(1)(2) nos. 1-6 AWV.

Critical infrastructure includes, inter alia, the following sectors:

- Telecommunications;
- Energy;
- Information Technology;
- Transport and Traffic;
- Health;
- Water;
- Nutrition;
- Finance and Insurance.

In addition, particularly security-relevant services are, inter alia, the following:

- Cloud Computing Services;
- Media Services (broadcasting, tele media, print products);
- Development and modification of software for the industry-specific operation of critical infrastructures within the meaning of the Act on the Federal Office for Information Security;
- Measures pursuant to Sec. 110 of the Telecommunications Act ("*Telekommunikationsgesetz*");
- Telematic infrastructure pursuant to Sec. 291b (1a) and (1e) of the German Social Code V ("*Sozialgesetzbuch V*");
- Personal protective equipment;
- Medicinal products essential for ensuring the health care of the population (including relevant source and active substances);
- Medical devices intended for the diagnosis, prevention, monitoring, prediction, prognosis, treatment or mitigation of life-threatening and highly contagious infectious diseases;
- In-vitro-diagnostic medical devices intended to provide information on physiological or pathological processes or conditions or to establish or monitor therapeutic measures in relation to life-threatening and highly contagious infectious diseases.

Moreover, the Regulation introduces a wide scope of economic sectors that may be controlled and reviewed[39]:

- critical infrastructure, whether physical or virtual, including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure;

[39] See in detail below under point C. II. 2).

- critical technologies and dual use items including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies;
- supply of critical inputs, including energy or raw materials, as well as food security;
- access to sensitive information, including personal data, or the ability to control such information; or
- the freedom and pluralism of the media.

It shall be emphasised that the thresholds of 25%, 10% respectively, must be reached or exceeded as a direct result of the acquisition.[40] If the foreign investor already holds 25%, 10% respectively, or more of the voting rights and subsequently acquires further voting rights, the later acquisition does not trigger the examination procedure (again). If, however, the acquirer initially holds less than 25%, 10% respectively, of the voting rights and subsequently acquires further voting rights, whereby the relevant acquisition threshold is reached or exceeded, the Ministry's right to review inevitably exists.[41]

The threshold of 25% finds its legal basis in corporate law. For the German legislator, the blocking minority ("*Sperrminorität*"), which is reached by acquiring 25% of the voting rights, of a foreign investor is decisive in order to assume a controlling influence.[42, 43]

However, the German legislator does not provide any concrete or comprehensible justification for establishing the 10% threshold for the critical infrastructure sector. In this context, it shall be emphasized, that the compatibility of the 10% threshold with European law is highly questionable.[44]

Attribution of Voting Rights

The AWV does not only cover the direct acquisition of shareholding, but also other forms of attribution facts.

If the foreign investor acquires less than 25%, 10% respectively, of the domestic company in a specific case, it is further to be examined, if the voting rights held by other companies or persons in the same domestic company must be attributed to the foreign investor.

[40] Pursuant to Sec. 12(1)(1) of the German Stock Corporation Act ("*Aktiengesetz*", AktG), every share of a stock corporation equals one voting right. The corresponding shareholders are entitled to vote in the GmbH. Pursuant to Sec. 47(2) GmbHG each euro of a share grants one vote.
It should be emphasised that preferred shares ("*Vorzugsaktien*") pursuant to Sec. 139(1) AktG, for which voting rights were excluded, are not to be taken into account when determining the relevant proportion of voting rights. Additionally, profit participation rights ("*Genussrechte*") pursuant to Sec. 221(3) AktG and silent partnerships pursuant to Sec. 230 et seq. of the German Commercial Code ("*Handelsgesetzbuch*") have to be disregarded when determining the relevant proportion of voting rights. The same applies to other legal positions such as call options, cash equity/total return swaps as well as pre-emption and pre-acquisition rights ("*Vorkaufs- und Vorerwerbsrechte*"), Seibt/Wollenschläger (2009), p. 837; Voland (2009), p. 520.
[41] Traugott/Strümpell (2009), p. 188; Mausch-Liotta (2017), § 55, para. 19.
[42] BT-Drs. 16/10730, p. 13.
[43] By acquiring a blocking minority, the foreign investor, inter alia, obtains the right to block transactions of the management board requiring approval, as well as to block amendments to the Articles of Association and the liquidation of the company, Reinhardt/Pelster (2009), p. 441.
[44] Cf. Stompfe (2019).

Pursuant Sec. 56(2) AWV, voting rights of companies in which the foreign investor holds at least 25%, 10% respectively, of the voting rights or with which it has concluded an agreement on the joint exercise of voting rights are attributable to the foreign investor.

Acquisition of further Shareholdings

By determining the relevant voting stake within the framework of Sec. 56(1) no. 1 AWV, those voting rights of third companies in which the foreign investor holds at least 25% or, in the field of critical infrastructure at least 10% of the voting rights, are initially to be attributed. If the foreign investor holds at least 25%, 10% respectively, of the voting rights in a third company, the German legislator assumes that this percentage (influence) is sufficient to persuade this company to exercise its voting rights in the interest of the foreign investor in the target company.[45]

Iterative Acquisition of Additional Voting Rights

Furthermore, Sec. 56(2) no. 1 AWV encompasses the constellation in which the acquisition of voting rights and the exceeding of the relevant threshold occurs by means of several purchases of voting rights. In this regard it has to be taken into account that it is not the upstream acquisition transaction, which finally triggers the Ministry's right to review, but only the acquisition through which the relevant threshold is actually exceeded.[46] A differentiated system of reporting thresholds does not exist within the scope of application of the AWV. The only decisive factor is the crossing of the 25% or 10% threshold.

Agreements on Exercising Voting Rights

Furthermore, pursuant to Sec. 56(2)(2) AWV, voting rights of third parties with whom the foreign investor has concluded an agreement on the joint exercise of voting rights ("*Stimmrechtsausübungsvereinbarungen*") are attributed to the foreign investor.

Agreements on exercising voting rights include all agreements between shareholders to vote or elect in a certain manner at the shareholders' meeting.[47]

The essential prerequisite for this form of attribution is that the agreement of exercising voting rights already exists at the time when the contract pertaining the acquisition of the domestic company by the foreign investor has already been concluded or that the agreement of exercising voting rights is concluded within the three-month period for the commencement of the examination procedure pursuant to Sec. 55(3) AWV.[48]

Furthermore, agreements of exercising voting rights must be of a long-term nature. Consequently, agreements of exercising voting rights for the individual case are excluded from

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[45] Mausch-Liotta (2017), § 56, paras 5-8.
[46] Cf. Söhner (2011), p. 459; Hasselbrink (2010), p. 515; Seibt/Wollenschläger (2009), p. 839; Traugott/Strümpell (2009), p. 191.
[47] Cf. von Bülow/Stephanblome (2008), p. 1797; Seibt/Wollenschläger (2009), p. 837.
[48] Pottmeyer (2018), §§ 55-59, para. 25.

the scope of application of Sec. 56(2)(2) AWV, since these agreements lack the required long-term and sustainable possibility of influencing the target company.[49]

Indirect Acquisitions

Pursuant to Sec. 55(3) AWV, a relevant attribution is further possible in cases in which the foreign investor only indirectly holds a shareholding in the domestic company ("*mittelbarer Erwerb*"), but the voting rights in the respective subsidiary companies are attributable to the foreign investor by application of the principles pursuant to Sec. 56(2) AWV.

The prerequisite for the attribution is that the foreign investor holds at least 25%, 10% respectively, of the intermediate company.[50] In the case of multi-level corporate structures, it has to be considered however, that the allocation chain is already interrupted if only one shareholding in an intermediate company does not reach the required threshold. Nevertheless, the attributable direct participation of the intermediate company in the target company itself may be below the 25% or 10% threshold.[51]

For example: the A-GmbH has its registered office in the Federal Republic of Germany. The B-GmbH, which also has its registered office in Germany, has a six percent share in this company. The non-EU C Inc. would like to acquire a share of 20 percent in the A-GmbH. In turn, the C Inc. has a share of 25 percent in the B-GmbH.

In this constellation, Sec. 56(2) no.2 AWV applies. The shares hold by the B-GmbH in the A-GmbH shall be attributed to the C Inc. As a result, the C Inc. reaches a share participation of 26 percent in the A-GmbH and therefore, exceeds the relevant threshold pursuant to Sec. 56(1) AWV.[52]

2) Likely Impairment of Public Order or Security

The Ministry's examination right was explicitly linked to a threat to public order or security ("*öffentliche Sicherheit oder Ordnung*") in Germany.

The indefinite legal concept of public order or security within the context of German foreign trade and payments regulations is not to be understood as the corresponding concept contained in German police and public order law, which in terms of content is considerably broader, but is rather to be determined according to EU law.[53]

Invoking the legal concept of public order or security was only permissible if there was a genuine and sufficiently serious threat affecting a fundamental interest of society in the

[49] Seibt/Wollenschläger (2009), p. 838.
[50] Cf. BT-Drs. 16/10730, p. 23; Reinhardt/Pelster (2009), p. 443.
[51] Seibt/Wollenschläger (2009), p. 838.
[52] Pottmeyer (2018), §§ 55-59, paras. 23 et seq. (with further examples).
[53] See Sec. 4(1) no. 4 and Sec. 5(2) AWG; Hindelang/Hagemeyer (2017), p. 883; BT-Drs. 16/10730, p. 10 et seq.; Reinhardt/Pelster (2009), p. 443.

particular case.[54] Therefore, public security or order concerns the core area of statehood and thus the safeguarding of Germany both internally and externally.[55]

A threat to public order or security existed if the target company is the operator of a critical infrastructure within the meaning of the Act on the Federal Office for Information Security or if it provided other particularly security-relevant services within the meaning of Sec. 55(1)(2) AWV.

In contrast, general economic, labour market or financial interests of the state do not fall under the concept of public order or security.[56] Therefore, the Ministry's right to screen foreign investment is, in principle, not suitable to protect against the relocation of manufacturing facilities overseas and for safeguarding jobs in Germany.[57]

It should, however, be expressly emphasized that as a result of the latest amendment of the AWG the Ministry's competence of review is substantially extended. Foreign investments in the area of cross-sectoral investment review can now already be restricted and prohibited if, as a result of the acquisition, the public order or security of the Federal Republic of Germany or another member state is likely to be impaired.

According to the corresponding explanatory memorandum, this stricter standard of review "shall emphasize the necessary forward-looking approach, which is inherent in investment screening anyway: an impairment that has not yet occurred but is possible in the future due to a critical acquisition event is to be prevented"[58].

The term "impairment" chosen by the legislator also makes it explicitly clear that, in terms of severity, a lower degree of risk will suffice in the future to impose prohibitions or restricting measures. Thus, the risk of intervention by the Ministry increases significantly. In the future, the Ministry will be able to prohibit transactions or impose measures based on the mere possibility that the transaction is "likely to impair" public order or security.

3) Scrutiny Procedure

Acquisitions by which the foreign investor acquires at least 10% of the voting rights in a company that operates within the critical infrastructure or provides certain particularly security-relevant services must be reported to the Ministry by the foreign investor.

Sec. 55(4) AWV explicitly states, that information about the conclusion of a contract governed by the law of obligations regarding the acquisition of a domestic company within the meaning of Sec. 55(1)(2) AWV or a direct or indirect acquisition of a stake within the meaning of Sec. 56 AWV of a domestic company by a non-EU resident shall be provided to the Ministry in writing. The notification shall specify the acquisition, the acquirer and the domestic enterprise to be acquired, as well as the business areas of the acquirer and of the domestic target company

[54] BT-Drs. 16/10730, p. 15.
[55] BT-Drs. 16/10730, p. 15.
[56] CJEU, Judgment of the Court of 4 June 2002 – Case C-367/98, para. 52.
[57] Cf. Seibt/Wollenschläger (2009), p. 839; Hasselbrink (2010), p. 516.
[58] BT-Drs. 19/18700, p.18.

to be acquired. The direct acquirer is obligated to notify the Ministry immediately after the conclusion of the sales contract.

Apart from this, foreign investors are not subject to any further notification requirements. However, the Ministry may initiate an ex officio examination within two months from the date of obtaining knowledge that the acquisition agreement has been concluded.[59] In this case, the Ministry is required to officially inform the direct acquirer and the target company about initiating the examination proceedings prior to the expiry of the two-month period.

In the event of initiating an examination procedure, the foreign investor is obliged to submit all documents and information relevant for an in-depth examination to the Ministry, which is to be determined by a general ruling.[60] The required documents and information, in principle, will include the following:

- Name and registered office of the direct acquirer and the domestic company;
- Shareholding: the amount of the direct and indirect voting rights held by the direct acquirer (i), before the acquisition, (ii) after the acquisition must be declared;
- Business operation: the nature of the business operation (i) of the direct acquirer, (ii) of the domestic company must be declared;
- It must be declared, if the domestic company is required to protect classified government information;
- State and local authorities are to be named with whom the domestic company has had business contacts in the last five years;
- All direct and indirect shareholders holding a stake (i) of the direct acquirer, (ii) of the domestic company must be disclosed;
- All direct and indirect shareholdings in third companies (i) of the direct acquirer, (ii) of the domestic company must be declared;
- Acquisition agreement: a copy of the acquisition agreement under the law of obligations must be submitted; in the case of an offer within the meaning of the WpÜG, a copy of the offer document must be submitted;
- Syndicate agreement: it has to be disclosed whether a syndicate agreement should exist for the post-acquisition period in respect of the target company. If so, a copy of the syndicate agreement must be provided;
- Business strategy: the short, medium and long-term business strategy of the target company for the post-acquisition period must be provided. Aspects relevant to the public order or security of the Federal Republic of Germany must specifically be disclosed;
- Trade Register Excerpt;
- Annual financial statements and management reports;
- Consolidated Financial Statements and Group Management Reports;
- Power of representation: the authorization of the person submitting the documents to represent the direct acquirer must be provided. In cases of a foreign investor, a person authorized to receive service in Germany must be named.

[59] Sec. 55(3) AWV in conjunction with Sec. 14a (1) no. 1 AWG.
[60] Sec. 14a (2) AWG.

In addition, the Ministry is permitted to request further documents for the examination. Once the complete documentation has been submitted, the acquisition can only be restricted or prohibited within four months.[61] The Ministry may extend this time limit by three months in individual cases if the examination procedure presents particular difficulties of a factual or legal nature. This period may be extended by a further month, if the acquisition particularly affects the defence interests of the Federal Republic of Germany.[62]

During the application process it is up to the discretion of the foreign investor to be assisted by or to rely on public affairs or lobbying specialists or sector experts. In this regard, there is no statutory prohibition.

The investment review proceedings do not trigger any fees or expenses, but the foreign investor must bear its own costs and expenses.

In Germany foreign investment decisions of an acquisition under the scope of the AWV are, in principle, not published and the Ministry is, in principle, bound by a strict confidentiality obligation.[63]

4) The Ministry's Powers to Act

The Ministry is responsible for carrying out the examination procedure. It is legally obliged to involve the other ministries concerned in the concrete case within the framework of their responsibilities.[64]

Pursuant to Sec. 59(1) AWV, the Ministry may prohibit both, the acquisition of an enterprise and the acquisition of a participation as defined in Sec. 56 AWV within four months after receipt of the complete documents requested in order to guarantee public order or security.

Furthermore, the Ministry is entitled to enact orders, it considers appropriate, to guarantee public order or security. For example, the foreign investor may be required to maintain certain supply-relevant branches of production permanently or for a certain period of time or to provide location guarantees.[65] Furthermore, orders may be issued to exclude certain business areas of the target company from the acquisition.[66]

Only the direct acquirer may be the addressee of administrative measures pursuant to Sec. 59 AWV. In the event of an indirect acquisition, it is the acquirer who acquires shares in a company which, in turn, directly or indirectly (as part of an acquisition chain) holds an interest in the target company.[67]

If the preconditions for a prohibition or an order are fulfilled, the Ministry's further action lies in its dutiful measurement of resolutions and selections. The actual exercise of discretion can only be subject to limited judicial review. An essential aspect of judicial review is the question

[61] Sec. 14a (2) no. 2 AWG.
[62] Sec. 14a (4) AWG.
[63] Cf. Sec. 3(1)(f) German Freedom of Information Act ("*Informationsfreiheitsgesetz*")
[64] BT-Drs. 16/10730, p. 24.
[65] Pottmeyer (2018), §§ 55-59, para. 48.
[66] Mausch-Liotta (2017), § 59, para. 20.
[67] Mausch-Liotta (2017), § 59, para. 4.

of whether the fundamental freedoms of the EU, the constitutional principle of equal treatment, fundamental rights and the principle of proportionality have been observed.

Prior to the issuance of a prohibition order or any other administrative order, the potential direct acquirer must be given the right to be heard in accordance with Sec. 28(1) VwVfG. Therefore, the potential direct acquirer must be informed of the Ministry's intention before issuing any adverse order.

The intentional or negligent infringement of an enforceable prohibition order or of any other permissible order pursuant to Sec. 59(1) AWV constitutes an administrative offence pursuant to Sec. 81(1) no. 6 AWV and may be subject to prosecution pursuant to Sec. 19(6) AWG in conjunction with Sec. 19(3) AWG with a fine in the total amount of up to EUR 500,000. However, if the economic advantage of the perpetrator exceeds this amount, the fine may also be set higher.[68]

5) Certificate of Non-Objection pursuant to Sec. 58 AWV

In order to obtain legal certainty at an early stage, the foreign investor is entitled to apply for a legally binding clearance certificate[69] from the Ministry prior to the acquisition in accordance with Sec. 58(1) AWV. The overriding statutory objective of a clearance certificate is to confirm that no objections with regards to public order or security exists.

In this regard, the written application must outline the main features of the planned acquisition, the acquirer, the domestic company to be acquired and the respective areas of business.

It shall be emphasized, that the right to submit an application for the issuance of a clearance certificate is not limited to the direct acquirer, but is expanded to any acquirer.[70] However, it should be reiterated that neither the seller nor the target company is entitled to file an application, unless they have explicitly been authorized by the acquirer.[71]

If the Ministry does not initiate a formal review within two months from the receipt of the written application of the acquirer for the issuance of a clearance certificate, the clearance certificate is deemed to have been issued.[72]

6) Legal Consequences

This expansion of the scope of review of the Ministry as demonstrated above has a direct impact on the relevant legal consequences. Previously, the catalogue of economic sectors classified as particularly security-relevant only provided for a mandatory notification to the Ministry without any direct impact on the final unrestricted signing of the sales contract.

[68] Cf. BT-Drs. 16/10730, p. 26; Mausch-Liotta (2017), § 59, para. 28.
[69] The terms „certificate of non-objection" and "clearance certificate" are used interchangeably in this contribution.
[70] Cf. Sec. 58(1) AWV.
[71] Pottmeyer (2018), §§ 55-59, para. 51.
[72] Sec. 58(2) AWV in conjunction with Sec. 14a (1) no. 1 AWG.

As a consequence of the latest AWG amendment, parties are imperatively confronted with a with a prohibition of execution of affected transactions. The amendments clearly state that the Ministry must approve affected transactions in advance. Hence, a legal transaction undertaken without the required authorisation is invalid.[73]

A legal transaction that serves to complete the acquisition of a domestic company or a direct or indirect participation in a domestic company is pendingly invalid. The legal transaction shall become effective from the time it is carried out if the Ministry releases the acquisition or does not prohibit it within the relevant time limits or if the release of the acquisition is deemed to have been granted.[74]

7) Legal Protection

The foreign investor is, in principle, entitled to legal protection under German administrative law against impaired measures of the Ministry in form of an action for annulment [“*Anfechtungsklage*”] pursuant to Sec. 42(1) (1st Alt.) VwGO.

It is undisputed that the direct acquirer as the direct addressee of the incriminating order is entitled to bring an action. His power to bring an action derives from the general freedom of contract, which is constitutionally guaranteed pursuant to Article 2(1) of the German Constitution (“*Grundgesetz*”, GG) as well as from the free movement of capital pursuant to Article 63 TFEU.[75] In addition, the right to bring an action of the seller results from its fundamental right under Article 14(1) GG to sell its shares. However, the target company and other shareholders do not have the right to bring an action.[76]

The legal action against the prohibition order or against any other order must be filed within one month after the official notification of the impairing order and must be directed against the Federal Republic of Germany as the legal entity of the Ministry.

II. Sector-Specific Review

1) Scope of Application

Rules on the screening of sector-specific foreign investments apply to the acquisition of companies operating in particularly security-sensitive sectors.

Pursuant to Sec. 60(1) AWV the Ministry can examine whether essential security interests of Germany are endangered if a foreigner acquires a domestic company or a direct or indirect participation[77] in a domestic company. This includes manufacturers and developers of war weapons and other key military technologies, specially designed engines and gearboxes for

[73] Sec. 15 (1) AWG.
[74] Cf. Sec. 15 (3) and (4) AWG.
[75] Müller/Hempel (2009), p. 1641; Seibt/Wollenschläger (2009), p. 844; Mausch-Liotta (2017), § 59, para. 23.
[76] Müller/Hempel (2009), p. 1641; Seibt/Wollenschläger (2009), p. 844; Mausch-Liotta (2017), § 59, para. 23.
[77] Within the meaning of Sec. 60a AWV.

military tracked armoured vehicles, and products with IT security features that are used for processing classified government information.

Any acquisition of a company by foreign investors whereby these acquire ownership of at least 10% of the voting rights of a company resident in Germany can be subjected to such review. The acquirer must be a foreigner within the meaning of Sec. 2(5) AWG. Therefore, in contrast to the cross-sectoral review procedure, Sec. 60-62 AWV also apply to EU investors.

Moreover, it is legally insignificant, if the foreign investor is a natural person or legal entity. Hence, subject to investment review are not only actual acquisition transactions, but also pure foreign financial investments.[78]

Acquisitions by German residents shall also be subjected to an examination if there are indications that an abusive approach or a transaction circumventing the law has been undertaken, not least partly in order to avoid an investment review pursuant to Sec. 60(1) AWV. Indications of an abusive approach within the meaning of Sec. 60 et seq. AWV in particular include cases where the direct acquirer does not maintain any business operations of its own other than the relevant acquisition or does not have any permanent establishment of its own including offices, staff and equipment within Germany.

In summary, sector-specific investment control concerns each foreign acquisition, without limitation to non-EU/EFTA foreigners, in areas which are particularly sensitive in terms of security, inter alia, military weapons and equipment as well as crypto technology.

2) Threat to "Essential Security Interests"

In particular, the sector-specific investment review aims at ensuring that the German government maintains direct legal access to the German defense industry and access to companies which produce crypto technology for encoding sensitive government information.[79]

The defense and crypto technology industry are considered as a security policy instrument and further as an essential requirement for an independent political and military capability for action.[80]

In this regard, the screening considers whether the respective acquisition poses a threat to essential security interests of Germany.

The term "essential security interests" derives from EU law and constitutes an indeterminate legal concept. Pursuant to Article 346(2) TFEU "any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for specifically military purposes".

According to the government reasoning "essential security interests" are jeopardized in cases, where security interests or military security precautions are impaired.[81] Therefore, the relevant

[78] Mausch-Liotta (2017), § 60, para. 11.
[79] BR-Drs. 5/04, p. 5.
[80] BR-Drs. 5/04, p. 6.
[81] BR-Drs. 5/04, p. 7.

acquisition transaction shall not negatively affect the government right of disposition of core abilities of the German defence industry.[82]

The explanations in terms of legal protection for cross-sectoral investments apply mutatis mutandis to sector-specific investments.

3) Scrutiny Procedure

Acquisitions subject to the sector-specific investment review must be reported by the foreign investor in writing to the Ministry.[83] The report shall cite the acquisition, the acquirer and the domestic company to be acquired and outline the fields of business in which the acquirer and the domestic company to be acquired are active.[84]

The Ministry shall issue a clearance in writing to the foreign investor if there are no objections to the acquisition in terms of essential security interests of the Federal Republic of Germany. The clearance shall be deemed to have been issued if the Ministry does not launch an examination procedure within two months of receipt of the complete documentation.[85]

The Ministry is responsible for carrying out the examination procedure. It involves the other ministries concerned in the specific individual case within the framework of their responsibilities. Orders or prohibitions are issued in agreement with the Federal Foreign Office, the Federal Ministry of Defence and – on IT matters – with the Federal Ministry of the Interior, for Construction and Home Affairs.[86]

The legal transaction on which the acquisition is based shall remain pending and invalid until the Ministry expressly or tacitly grants the release within the above-mentioned periods.[87]

C. Practical Implications of the New Legal Framework for Foreign Direct Investment in the European Union

In March 2018, following an initiative of Germany, France and Italy, the Council of the EU approved a *Regulation on establishing a framework for screening of foreign direct investments into the European Union*.

The new Regulation entered into force on 10 April 2019 and became effective on 11 October 2020.

The Regulation creates an enabling framework for Member States to screen foreign direct investments on grounds of security and public order. The Regulation does not require Member States to adopt a screening mechanism for foreign direct investment, nor does it exhaustively

[82] BR-Drs. 5/04, p. 5.
[83] Sec. 60(3)(1) AWV in conjunction with Sec. 58(1)(2) AWV.
[84] Cf. Sec. 60(3)(2) AWV.
[85] Sec. 61 AWV.
[86] BMWi (2019).
[87] Cf. Pottmeyer (2018), §§ 60-62, para. 41.

mandate the substantive or procedural features for screening mechanisms. It only sets out basic requirements that should be common to Member States' screening mechanisms.

Furthermore, the Regulation creates a co-operation mechanism between Member States to share information about foreign direct investment planned or completed on the territory of one or several Member States. It also provides the possibility for other Member States and the Commission to comment on such investment, but leaves the final decision on the appropriate response to the Member States in which the investment is planned or completed.

Moreover, the Regulation introduces the possibility for the Commission to screen foreign direct investments which are likely to affect projects or programmes of Union interest on security and public order grounds.

At least according to official EU announcements, the new Regulation does not attempt to harmonize the existing investment screening mechanisms of the Member States or to introduce an EU-wide screening mechanism. However, there is no doubt that the Regulation will have a very practical impact on foreign direct investments into the EU, both in substance and procedure.

I. Background

The European Commission ("**EC**") constantly emphasizes that the EU maintains an open investment environment and welcomes foreign investment.

In its recent Reflection Paper on "Harnessing Globalisation" issued on 10 May 2017, the EC confirmed that openness to foreign investment remains a key principle for the EU and a major source of growth, but at the same time it recognised that there have been some concerns about foreign investors, notably state-owned enterprises, taking over European companies with key technologies for strategic reasons, and that EU investors often do not enjoy the same rights to invest in the country from which the investment originates.

The list of controversial company takeovers and acquisitions of major European companies is getting longer and longer. Kuka, Aixtron or OSRAM light are just a few examples.

Against this backdrop, the growing political will to more actively screen, control, and ultimately even prevent foreign direct investments flowing into Europe does not come as a surprise.

In this regard, screening mechanisms on the national level are not a novel tool. Rather, almost half of the EU Member States maintain foreign investment control regimes, i.e. Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain, and the United Kingdom.

In particular, the new EU Regulation is to be seen in the context of recent amendments to foreign investment review laws in Europe's major economies Germany and France.

In December 2018, as comprehensively demonstrated and analysed above, the German government has passed amendments to the AWG and AWV.

In this regard, the German legislator has lowered the threshold for the screening of FDI to the acquisition of 10% of the voting rights of a German company being active in the military and encryption sector and of German companies which are operating in the field of critical infrastructure according to the Regulation for Identifying Critical Infrastructure.

At first, the French foreign investment review regime was limited to as small number of business activities, in particular to gambling, private security services, weapons, warfare equipment and cryptology. However, due to serious amendments to the French Monetary and Financial Code by Decree No. 2014-479 dated 14 May 2014 and Decree No. 2018-1057 dated 29 November 2018 the right of the French Ministry to review and restrict foreign investment has substantially been increased.

With solid and reasonable arguments, it can be concluded that the Regulation as well as the relevant national laws seriously struggle to establish an appropriate balance between addressing legitimate concerns with regard to certain FDIs, in particular those originating from state-owned enterprises and sovereign wealth funds, and the need to maintain an open and positive regime for such investment into the EU.

II. The new EU investment screening regime

In general, the overriding objective of the Regulation is to provide a framework of substantial and procedural rules for the Member States, and the EC to screen and control FDI in the EU. The precondition for issuing any screening decisions are impairing grounds on "public order and security". The main features of the Regulation are described below.

1) Scope of application

One main characteristic of the Regulation is a broad definition of FDI.

The Regulation defines FDI as an investment of any kind by a foreign investor aiming to establish or to maintain lasting and direct links between the foreign investor and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity in a Member State, including investments which enable effective participation in the management or control of a company carrying out an economic activity.

In addition, "foreign investor" means a natural person of a third country or a legal entity (undertaking) of a third country, intending to make or having made a foreign direct investment.

It must be highlighted that any post-Brexit UK investors are going to be qualified as "foreign investors" within the meaning of the Regulation.

2) Relevant economic sectors

The Regulation introduces a wide scope of economic sectors that may be controlled and reviewed:

- critical infrastructure, whether physical or virtual, including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure;
- critical technologies and dual use items including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies;
- supply of critical inputs, including energy or raw materials, as well as food security;
- access to sensitive information, including personal data, or the ability to control such information; or
- the freedom and pluralism of the media.

In that regard, it is also possible for Member States and the EC to take into account the context and circumstances of the FDI, in particular whether a foreign investor is controlled directly or indirectly by foreign governments, for example through significant funding, including subsidies, or is pursuing State-led outward projects or programmes.

3) No minimum threshold

It must explicitly be pointed out that the Regulation, contrary to national regulations such as in Germany and France, does not impose any minimum threshold for the screening of FDI, neither regarding the total amount nor pertaining the corporate stake.

4) Minimum requirements

The Regulation establishes framework rules which Member States must adhere to that already maintain an FDI screening regime or wish to adopt one. These rules, inter alia, include the following:

- Member States shall set out the circumstances triggering the screening, the grounds for screening and the applicable detailed procedural rules;
- Member States shall apply timeframes under their screening mechanisms;
- Confidential information, including commercially-sensitive information, made available to the Member State undertaking the screening shall be protected;
- Foreign investors and the undertakings concerned shall have the possibility to seek recourse against screening decisions of the national authorities;
- Member States which have a screening mechanism in place shall maintain, amend or adopt measures necessary to identify and prevent circumvention of the screening mechanisms and screening decisions.

5) Co-operation mechanism regarding FDI <u>undergoing</u> screening

The Regulation introduces a co-operation mechanism between Member States and the EC. In this context, Member States shall notify the EC and the other Member States of any foreign direct investment in their territory that is undergoing screening by providing the following information as soon as possible:

- the ownership structure of the foreign investor and of the undertaking in which the foreign direct investment is planned or has been completed;
- the approximate value of the foreign direct investment;
- the products, services and business operations of the foreign investor and of the undertaking in which the FDI is planned or has been completed;
- the Member States in which the foreign investor and the undertaking in which the foreign direct investment is planned or has been completed conduct relevant business operations;
- the funding of the investment and its source, on the basis of the best information available to the Member State;
- the date when the foreign direct investment is planned to be completed or has been completed.

Based on the information received, Member States are entitled to make comments on FDI in another Member State, if that FDI is likely to affect its security or public order, or has information relevant for such screening.

Where the EC considers that a foreign direct investment undergoing screening is likely to affect security or public order in more than one Member State, or has relevant information in relation to that foreign direct investment, it may issue an opinion addressed to the Member State undertaking the screening. The EC may issue an opinion irrespective of whether other Member States have provided comments.

Generally, comments or opinions shall be addressed to the Member State undertaking the screening and shall be sent to it within a reasonable period of time, and in any case no later than 35 calendar days following receipt of the information stated above. It must be considered though, that this timeframe may be extended to an additional 20 days in cases additional information were requested.

In any event, the Member State undertaking the screening shall give due consideration to the comments of the other Member States and to the opinion of the EC. However, the final screening decision shall be taken by the Member State undertaking the screening.

6) Co-operation mechanism regarding FDI <u>not undergoing</u> screening

Where a Member State considers that an FDI planned or completed in another Member State which is not undergoing screening in that Member State is likely to affect its security or public order, or has relevant information in relation to that foreign direct investment, it may provide comments to that other Member State.

The same applies to the EC which is entitled to issue an opinion in cases where FDI is not undergoing screening in the relevant Member State.

The most controversial element in this regard, resulting in great legal uncertainty for planned and even completed FDI is, that making comments and issuing an opinion is allowed up to 15 months after the FDI has been "successfully" completed.

7) FDI likely to affect projects or programmes of Union interest

Where the EC considers that an FDI is likely to affect projects or programmes of Union interest on grounds of security or public order, the EC may issue an opinion addressed to the Member State where the foreign direct investment is planned or has been completed.

In this regard, projects or programmes of Union interest shall include those projects and programmes which involve a substantial amount or a significant share of Union funding, or which are covered by Union law regarding critical infrastructure, critical technologies or critical inputs which are essential for security or public order.

In particular, this includes the following projects or programmes: Galileo & EGNOS, Copernicus, Horizon 2020, TEN-T (Trans-European Networks for Transport) and TEN-E (Trana-European Networks for Energy).

III. Practical implications

The mechanisms on foreign investment screening have become an increasingly relevant issue in cross-border transactions that require an in-depth legal risk assessment and management prior to concluding the transaction.

In particular, the new Regulation will lead to the following:

(1) The lack of any minimum threshold grants the EC and other Member State a wide authority to directly interfere in the screening process of FDI in a specific Member State.

(2) Due to the right to directly interfere in the FDI screening of a particular Member State it cannot be ruled out that major European economies are going to force smaller Member States to impede certain FDI, in particular in sensitive sectors.

(3) The Regulation in conjunction with the current amendments of relevant national laws in major European economies further enlarges legal policy protectionism towards FDI.

(4) The new Regulation establishes a dual-system of review and control of FDI on the European level. In addition, to screening acquisition transactions under a merger control perspective pursuant to the EC Merger Regulation, the EC now has the competence to review transactions and issue opinions from an FDI perspective.

(5) The Regulation will have a serious impact on the timing of FDI screening. Due to the right of other affected Member States to provide comments and the right of the EC to issue an opinion, flanked by the obligation of the host state (the state where the investment is made) to properly consider those comments and opinions, national

scrutiny procedures are likely to be delayed. Furthermore, as a direct consequence, the Regulation will decouple national scrutiny procedures from the short initial review phase pertaining merger control pursuant to Article 10 EC Merger Regulation.

(6) The statutory right of Member States and the EC to provide comments, issue an opinion respectively, for up to 15 months after the relevant transaction has already been completed creates great legal uncertainty. Especially taken into consideration that, e.g. in Germany and France, the transaction shall remain pending and ineffective until the final approval of the competent government authority. In consequence, this procedural element by itself may further tremendously delay the finalization of cross-border M&A transactions.

(7) The Regulation, inevitably, will rise further awareness of the sensitivities originating from FDI, which in turn may lead to an alignment of substantial and procedural rules of Member State that, until now, are having a less comprehensive investment review regime.

(8) This is not the end – it is just the beginning: until today, the new Regulation only grants the EC a "coordinating role". However, the EC, on a regular basis, in its own publications, emphasizes that other elements will be further assessed accompanying the Regulation. Therefore, considering the unstoppable regulatory craze in Brussels, it is to be expected, that the competences of the EC, regarding the review and control of FDI, will be substantially enlarged in the near future.

(9) The scope of the Regulation underscores the importance of expanding the substantive protection standard of National Treatment contained in the vast majority of Bilateral Investment Treaties also to the pre-investment stage.

(10) Major missing element: the Regulation does not contain any default provision for cases where Member States fail to duly consider the comments of other Member States or the opinion of the EC or even completely fail to duly inform other Member States likely to be affected by the FDI in question.

D. About the Author

Dr. Philipp Stompfe, LL.M. (London) is attorney at law at Alexander & Partner (Berlin/Stuttgart/Paris/Vienna/Doha/Riyadh/Ras Al Khaimah/Cairo/Muscat). Dr. Stompfe is primarily involved in international litigation and arbitration. He regularly represents and advises states and commercial clients in international commercial and investment arbitration. He is specialized in international investment and economic law as well as in public international law.

Furthermore, Dr. Stompfe is a Professor of Law at the University of Southern Denmark for public international law, private international law and international business law. He is further an Adjunct Professor in international investment and business law at the University of Cologne/Germany and the University of Saarbruecken/Germany.

Dr. Philipp Stompfe is constantly acting as counsel in commercial arbitrations before all of the major arbitral institutions mainly related to construction, energy, distribution, real estate and M&A disputes. He further advises on international contract, corporate and construction law (FIDIC, NEC, VOB) and on the structuring and implementation of cross-border investment projects in the Gulf States. Dr. Stompfe has negotiated, drafted and enforced numerous construction contracts based on the FIDIC Red, Silver and Yellow Book.

Dr. Stompfe regularly publishes on public international law, international business and investment law as well as on topics of international arbitration.

Philipp Stompfe has lived and studied in the Middle East and has great knowledge of Arab legal systems, in particular with regard to Qatar, UAE, Kuwait, Libya and Egypt. Prior to joining Alexander & Partner in 2017, Philipp Stompfe worked for an international law firm being mainly responsible for the structuring and implementation of construction and infrastructure projects in the MENA-Region, especially in Libya and Qatar.

Philipp Stompfe studied law at the University of Marburg (Germany) and passed his first State Exam (J.D. equivalent) in 2010. He obtained his LL.M. (Master of Law) in International Business Law and International Dispute Resolution from Queen Mary University of London. In 2016, he received his doctor‘s degree with *summa cum laude* from the University of Cologne (Germany) for his doctoral dissertation on “The Formation and Protection of International Investment Agreements in the Arab World and Example of Libya and Qatar“. He was awarded the Best Dissertation in International Law of 2016 by Osborne Clarke.

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