



## Reform of Foreign Investment Control in Germany

Germany passed a significant reform of its foreign investment control regime. The Federal Ministry for Economic Affairs and Energy (*Bundesministerium für Wirtschaft und Energie* – “BMW”) may review the direct or indirect acquisition of shares in a German company by a foreign acquirer above a certain threshold. The relevant provisions in the Foreign Trade Ordinance (*Außenwirtschaftsverordnung* – “AWV”) have been amended effective 18 July 2017 by the Ninth Ordinance amending the AWV (*Neunte Verordnung zur Änderung der Außenwirtschaftsverordnung*) (“New AWV”).

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In particular, the reform refines the legal test by which any foreign investments are assessed, namely whether they endanger public order or security. The German government increasingly aims at protecting critical infrastructures which are of strategic importance. The newly introduced more robust investment control regime will be supported by more stringent procedures and longer review deadlines for the government. There are no changes to the threshold which triggers the review, namely the acquisition of 25 percent of the voting rights in a German company.

The primary purposes of the New AWV are to ensure fair competitive conditions, in particular in view of more protectionist foreign economic systems, and to efficiently protect the security interests of the Federal Republic of Germany. In view of a continuously increasing number of foreign investments into German companies, a constantly growing significance of key infrastructures and a rapid development of military and defense technology over the past years, the reform of the existing foreign investment control regime is mainly driven by a changing security situation.



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## The Previous German Foreign Investment Control Regime in a Nutshell

Under the previous foreign investment control regime, the BMWi may review direct or indirect foreign investments in a German company provided that, after the acquisition, the foreign acquirer holds a direct or indirect participation of at least 25 percent of the voting rights in the German company. There are two regimes, a sector-specific investment review for the defense and encryption sectors (sec. 60 et. seqq. AWV) and a cross-sectoral investment review for all other sectors (sec. 55 et. seqq. AWV).

### 1. Sector-specific Investment Review (Defense and Encryption)

The BMWi can examine whether essential security interests of the Federal Republic of Germany are endangered if a foreign investor (including EU residents outside Germany) acquires a direct or indirect participation in a German company which (i) manufactures or develops goods within the meaning of Part B of the German War Weapons List (*Kriegswaffenliste*), (ii) manufactures or develops specially designed engines or gears to drive battle tanks or other armored military tracked vehicles, or (iii) manufactures products with IT security functions to process classified state information or components essential to the IT security function of such products.

The BMWi shall clear the transaction (*Freigabe*) if there are no objections in terms of essential security interests of the Federal Republic of Germany. In case there are any such objections, the BMWi can prohibit the acquirer from closing the acquisition or issue instructions.

### 2. Cross-sectoral Investment Review (Other Sectors)

With respect to all other acquisitions of a German company, the BMWi may examine whether the public order or security of the Federal Republic of Germany is endangered if a non-EU resident acquires a direct or indirect participation in a German company above a certain threshold (cross-sectoral examination).

The notion of public order or security originates from European law. According to well-established case law of the European Court of Justice, an acquisition endangers the public order or security of a EU Member State if and to the extent it affects “fundamental interests of society”. On the basis of such narrow understanding of public order or security, the BMWi has in the past particularly investigated acquisitions which potentially affected national security, e.g., as they related to business areas in or close to the military or defense industry.

Upon application, the BMWi shall issue a certificate of non-objection (*Unbedenklichkeitsbescheinigung*) if there are no objections to the acquisition in terms of public order or security of the Federal Republic of Germany. As with the sector-specific examination regime, the BMWi can prohibit or restrict the acquisition.



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### 3. Procedural Details

Under the previous sector-specific examination regime, clearance of the acquisition by the BMWi is a statutory closing condition. In contrast, under the cross-sectoral examination regime, there is no obligation to notify the transaction to the BMWi but the acquirer may voluntarily apply for a certificate of non-objection which clears the transaction. If the acquirer does not apply for a certificate of non-objection, the BMWi can open investigation proceedings. Prior to the New AWV, the deadline to open such *ex officio* investigations ended three months after signing of the relevant share purchase agreement or, in case of an offer within the meaning of the Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*) (“**Public Offer**”), after publication of the decision to submit the offer or after publication of the assumption of control. After such three months period, any investigation proceedings were excluded, irrespective of the point in time at which the BMWi obtained knowledge of the transaction.

Under both investment control regimes, the application for clearance resp. certificate of non-objection must include a description of the acquisition, the acquirer and the German company to be acquired as well as the basic features of the fields of business of the acquirer and the target. Prior to the New AWV, the clearance or certificate of non-objection was deemed to have been issued if the BMWi did not open investigation proceedings within one month of receipt of the application.

Should the BMWi open investigation proceedings (upon application or *ex officio*), it may request additional information from the acquirer and, where necessary, issue prohibitions or instructions. Prior to the New AWV, the clearance or certificate of non-objection was deemed to have been issued if the BMWi did not issue such prohibitions or instructions (i) within one month after receipt of the full relevant documentation in case of the sector-specific examination or (ii) within two months after receipt of such documentation in case of the cross-sectoral examination.

### 4. Examination and Clearance Practice of the BMWi to Date

To this day, we are not aware of a single foreign investment in a German company that was prohibited by the BMWi. Based on information published by the BMWi in November 2016, since the introduction of the cross-sectoral examination regime in 2009, until then 336 acquisitions had been successfully cleared on the basis of sector-specific and cross-sectoral investment reviews. In only one case, upon parliamentary inquiries the BMWi conducted an *ex officio* investigation.

Recently, however, a number of cases have been subject to comprehensive investigations by the BMWi, including negotiations on security arrangements. In November 2016, the BMWi withdrew a certificate of non-objection provided for the Aixtron acquisition, which in December 2016 was prohibited by the United States on national security grounds.



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## Material Amendments by the New AWV

The New AWV significantly changes Germany's foreign investment control regime. In particular, the reform has refined the notion of public order or security and modifies procedures and deadlines. There are no changes to the threshold which triggers the review (acquisition of 25 percent of the voting rights in a German company).

### 1. Broader Notion of Public Order or Security; Particularly Sensitive Business Areas

The New AWV has refined the notion of public order or security by stipulating a non-exhaustive list of particularly sensitive business areas which relate to critical infrastructures (sec. 55 para 1 sentence 2 of the New AWV). A foreign investment in German companies which are active in the following business areas may in particular be considered as threatening public order or security:

- a. **Operations of critical infrastructures** within the meaning of the Law on the Federal Office for Information Security (*Gesetz über das Bundesamt für Sicherheit in der Informationstechnik – "BSIG"*)

Critical infrastructures are defined as follows (sec. 2 para 10):

Assets, systems or parts thereof which belong to the industry sectors (i) energy, (ii) information technology and telecommunication, (iii) transport and haulage, (iv) health, (v) water, (vi) nutrition, (vii) finance and insurance *and* which are of high importance for the functioning of the community since their failure or impairment would result in serious supply shortages or considerable disruption of public safety

- b. **Development or modification of industry-specific software for the operation of critical infrastructures**

An exhaustive list of the relevant industry-specific software is provided for in sec. 55 para 1 sentence 3 of the New AWV.

The list refers to, *inter alia*, (i) software for the power plant or network control technology in the energy sector, (ii) software for the control and automation technology in the water sector, (iii) software for the collection, processing and transfer of data in the information technology and telecommunication sector, (iv) software for cash supply, cardbased payments or security transactions in the finance and insurance sector, (v) software for hospital information systems or the marketing of prescription drugs in the health sector, (vi) software for the air, rail or road transport of passengers and goods in the transport and haulage sector and (vii) software for food supply in the nutrition sector.



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- c. **Implementation of organizational measures in relation to telecommunication surveillance measures under sec. 110 of the Federal Telecommunications Act**
- d. **Provision of certain cloud computing services using infrastructures which reach or exceed certain threshold values**
- e. **Owners of an authorization for components or services relating to the telematics infrastructure which connects various stakeholders under the German statutory health insurance funds regime and allows for the exchange of relevant information between these stakeholders**

This broad catalogue of particularly sensitive business areas broadens the notion of public order or security as established in the administrative practice of the BMWi until today.

**2. Extended Scope of the Sector-specific Examination Regime**

Under the New AWV, the scope of application of the sector-specific investment review shall extend to foreign investments in German companies which

- a. **manufacture or develop goods subject to list positions 0005, 0011, 0014, 0015, 0017 of Part I Section A of the German Export List (*Ausfuhrliste*; Annex 1 to the AWV), including, inter alia, fire control instruments, weapon sights, detection and identification devices, sensor integration equipment, space vehicles, specialized equipment for military education, imaging and countermeasure equipment, diving devices, robots, nuclear energy production equipment or laser equipment, each specially designed for military use;**
- b. **manufacture or develop goods subject to list position 0018 of Part I Section A of the German Export List which are specially designed for the manufacturing, certification, qualification or testing of the goods listed under 2.a. above.**

**3. Procedural Reforms**

There are also important procedural revisions of the existing foreign investment control regime, in particular as regards applicable timeframes, review and investigation deadlines as well as content and scope of notification obligations:

- a. **Extension of review period for ex officio investigations under the cross-sectoral examination regime**

The BMWi may now open *ex officio* investigations within three months after *becoming aware* of the signing (execution) of the relevant share purchase agreement, however, *not later than five years* after signing (sec. 55 para 3 of the New AWV). Accordingly, if the BMWi did not obtain knowledge of the transaction namely because the acquirer did not notify the transaction and apply for a certificate of non-objection, legal certainty as to the successful completion of the acquisition could be obtained no earlier than five years after signing of the share



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purchase agreement. In case of a Public Offer, the relevant deadlines are triggered by the BMWi becoming aware of the publication of the decision to submit the offer or of the assumption of control.

#### b. Notification obligations for particularly sensitive acquisitions under the cross-sectoral examination regime

Under the new regime, *signing* of a share purchase agreement relating to an acquisition in one of the newly defined sensitive business area outlined above must be *notified in writing* to the BMWi (sec. 55 para 4 of the New AWW). According to the regulator, the purpose of this reform is to ensure that the BMWi becomes aware of particularly safety-relevant acquisitions at an early stage of the transaction. There is no deadline for this notification but as the notification triggers the three months period during which the BMWi may open *ex officio* investigations, the parties may have an interest in notifying signing as early as possible.

The new regulation does not explicitly require such notification to include an application for a certificate of non-objection. However, for practical purposes, it seems advisable to combine notification and application. First, this approach allows the parties to bring down the deadline during which the BMWi may open *ex officio* investigations to a two months period (cf. sec. 58 para 2 of the New AWW). Second, the mere notification of a particularly safety-relevant acquisition without (substantiated) application for a certificate of non-objection creates a risk that the BMWi would open investigation proceedings and request comprehensive information from the foreign investor on the envisaged acquisition. This could significantly delay clearance and completion of the transaction.

With the exception that the three months period does not start running, there are no further sanctions in case an acquisition is not notified. In particular, the notification obligation does not qualify as a statutory closing condition. Also, there are no specific requirements as to the form and substance of the notification. Any application for a certificate of non-objection would fulfill the notification obligation even if the application did not refer to a “notification” or did not make reference to the legal notification obligation.

#### c. Extension of information obligations to all parties of the transaction

In future, for the purposes of its investigation, the BMWi may *request relevant information from all parties involved in the transaction*, including the German company (sec. 57 para 3 of the New AWW). This provision takes account of the fact that the direct or indirect acquirer is not in all instances able to collect and provide sensitive information on the business of the target company, although typically the transaction documentation would provide for information rights of the purchaser against the selling shareholder.



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### d. Prolongation of BMWi review and investigation periods

Under the New AWV, certain time periods and deadlines have been extended to provide the BMWi with more time for the review of applications and for its investigations.

- Clearance under the sector-specific examination regime shall be deemed to have been issued if the BMWi (i) does not open investigation proceedings within *three months* of receipt of the application (instead of one month; cf. sec. 61 sentence 2 of the New AWV) or, in the case of investigation proceedings, (ii) does not prohibit or restrict the acquisition within *three months* (instead of one month) after receipt of the full relevant documentation from the acquirer (cf. sec. 62 para 1 of the New AWV).
- The certificate of non-objection under the cross-sectoral examination regime shall be deemed to have been issued if the BMWi (i) does not open investigation proceedings within *two months* of receipt of the application (instead of one month; cf. sec. 58 para 2 of the New AWV) or, in the case of investigation proceedings, (ii) does not prohibit or restrict the acquisition within *four months* after receipt of the full relevant documentation from the acquirer (instead of two months; cf. sec. 59 para 1 of the New AWV).

### e. Security arrangements with the BMWi

Should the BMWi open investigation proceedings to assess particularly sensitive acquisitions, it is common administrative practice that the BMWi enters into negotiations with the parties of the transaction on contractual arrangements to protect the security interests of the Federal Republic of Germany (security arrangements). Under the New AWV, the expiration of the applicable *investigation periods shall be suspended for the duration of the negotiations of such security arrangements* (cf. sec. 59 para 2, 62 para 2 of the New AWV). Negotiations with the BMWi on security arrangements may result in a significant delay of the closing of an acquisition.

### f. Allocation of costs for unwinding a completed acquisition

Under the cross-sectoral examination regime, in case the BMWi prohibits an acquisition which has already been closed, the New AWV clarifies that a trustee can be appointed at the cost of the foreign investor to unwind the transaction (sec. 59 para 3 no. 2 AWV).



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## Practical Implications of the New AWV

The revised German foreign investment control will have considerable importance for M&A transactions by foreign investors on the German market. Due to the new notification obligations for particularly sensitive acquisitions under the cross-sectoral examination regime, the BMWi expects approximately ten additional applications and five additional comprehensive investigation proceedings per year. With regard to the extended scope of the sector-specific examination, the BMWi anticipates three additional sector-specific investment reviews per year. Apart from that, the BMWi foresees two additional negotiations on security arrangements per year.

Even more than before, foreign investors should pay particular attention to German foreign investment control at an early stage of their investments in Germany. We recommend conducting an initial legal and risk assessment under the New AWV already in the course of the due diligence process, including an evaluation of the sensitivity of the target's business (e.g., critical infrastructures or industry-specific software) and of the BMWi clearance process.

Should the envisaged acquisition relate to particularly sensitive business areas such as critical infrastructures, foreign investors should bear in mind that notification to the BMWi under the cross-sectoral examination regime is now mandatory. In the interest of transaction security, we would generally advise a foreign acquirer to prepare for notification and apply for a certificate of non-objection in order to pass through German foreign investment control in the shortest deadlines possible.



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