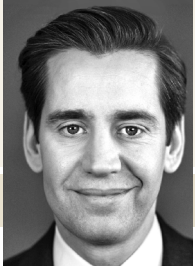

Dr. Tim Kaufhold
Partner and Attorney at Law
of P+P Pöllath + Partners, Munich

The Tightening of Foreign Investment Review Laws: New Challenges for M&A Practitioners

This year's tightening of investment review under the Foreign Trade Act (*Außenwirtschaftsgesetz, AWG*) and the Foreign Trade Ordinance (*Außenwirtschaftsverordnung, AWV*) causes new challenges for M&A practitioners. In particular, the scope of application has been expanded, a stand-still obligation for notifiable investments has been introduced and the criteria for prohibitions have been lowered. The effect on M&A transactions is potentially significant and may even concern transactions which might seem unproblematic at first glance. In addition, the Federal Government is currently coordinating plans to further tighten investment review rules.

Scope of application of foreign investment review laws

Foreign investment review applies to direct and indirect investments in German companies by investors from outside the EU or the EFTA (so-called non-EU residents). If the target company is active in a specific area, listed in a catalogue of sensitive areas, foreign investment review already applies to acquisitions of at least 10 % of the voting rights in such company. Such investments are subject to notification requirements and a stand-still obligation applies until clearance has been granted by the Federal Ministry of Economics and Energy (*Bundeswirtschaftsministerium, BMWi*). For all other areas, the review initiation threshold is 25 % and neither notification requirements nor a stand-still obligation apply. However, the BMWi can examine such investments *ex officio*. Special rules apply for target companies which produce or develop certain military products. Asset deals are within the scope of foreign investment review laws.

Since indirect investments are also caught, an investment by an EU resident may be subject to review, if such EU resident is controlled by a non-EU resident.

Daniel Wiedmann, LL.M.
Associated Partner and Attorney at Law
of P+P Pöllath + Partners, Frankfurt/Main

Whether this also applies if the non-EU resident acquirer only holds a share of at least 10 % or 25 %, respectively, in the EU resident, is still an unsettled question.

Catalogue of sensitive areas: Notification and stand-still obligations

If the German target company is active in a listed sector, as described above, an investment of at least 10 % it is subject to a notification obligation and a stand-still obligation.

The specific areas are listed in section 55, para. 1 AWV and, *inter alia*, comprise companies active in the field of critical infrastructure and corresponding software. In reaction to the Covid-19 pandemic, various fields in the health sector were added.

Critical infrastructures are defined as facilities, equipment or parts thereof, which are part of the sectors energy, information technology and telecommunications, transportation and traffic, health, water, nutrition, and the finance and insurance industries and are of high importance to the functioning of the community. Further details are laid down in the Regulation regarding the Definition of Critical Infrastructure according to BSI legislation (*Verordnung zur Bestimmung Kritischer Infrastrukturen nach dem BSI-Gesetz*).

Companies, offering software in this area, may also be caught. The question of whether software industry-specifically serves the operation of critical infrastructure can give rise to difficult questions of interpretation.

In reaction to the Covid-19 pandemic, the scope of application was expanded to companies developing, producing or distributing certain pharmaceuticals, medical products, in-vitro diagnostics or personal protection equipment. The scope of application is especially broad in in the field of pharmaceuticals, which comprises pharmaceuticals that are essential for safeguarding the healthcare

of the population, including their source materials and active ingredients and vaccines considered relevant or critical by the Federal Institute for Drugs and Medicinal Products (*Bundesamt für Arzneimittel und Medizinprodukte*).

Effects on M&A transactions

The buy-side as well as the sell-side should carefully consider possible foreign investment review risks and their impact on the deal timetable. This concerns, in particular, the question of whether a stand-still obligation may apply to the transaction. If a stand-still obligation applies, the transaction must not be consummated before the BMWi has granted its approval. However, even if no stand-still obligation applies, the BMWi may investigate transactions ex offico. As the BMWi has the power to prohibit transactions, or to impose orders, parties should also be considerate of substantive risks.

- The key question is whether an investment falls within the scope of investment review, which especially requires an assessment of the buy-side, i.e., whether the direct or indirect acquirer is a non-EU resident. If the transaction is, in addition to the above said, notifiable because of the activities of the target company, specific provisions should be included in the share or asset purchase agreement. Still, also non-notifiable transactions ought to be assessed regarding possible risks, depending on the identity of the purchaser and the area of activity of the target company.

- Notifiable investments are subject to a stand-still obligation. This means that a notifiable investment or the underlying legal transaction is provisionally invalid. It only becomes (retroactively) effective once the BMWi clears the transaction or does not timely block the transactions or clearance is deemed to be granted. Clearance by the BMWi (or its fiction) should therefore be included as a condition precedent to closing in the share or asset purchase agreement.

- Often times, this condition precedent to closing will be accompanied by a merger control law condition precedent. However, the timing of these re-

views is not aligned. In most cases, clearance by the merger control authorities is granted within one month and often within a few weeks. In very rare cases the review lasts four or exceptionally more months. In contrast, the BMWi initially examines within two months whether an in-depth examination is necessary. In our experience, quick approvals, for example within one month, are rare. If the BMWi starts an (in-depth) examination process, the review period is extended by four months, starting with the submission of additional information. The BMWi can extend this period by further three months if the examination process reveals special difficulties of factual or legal nature. Additional extensions are possible. From a practical point of view, an essential difference between the merger control and foreign investment review process lies in the fact that at the Federal Cartel Office (*Bundeskartellamt*) only one rapporteur or decision division reviews a transaction, whereas the relevant department within the BMWi must coordinate the case with different divisions (and other ministries).

- Other issues, which must be considered in the share or asset purchase agreement, may *inter alia* concern the process of submission (timing, cooperation obligations, information and participation rights) and the risk allocation (for example in case of a prohibition, orders being imposed or procedural delays). The question of risk allocation will likely gain relevance, particularly in view of the lowering of the prohibition threshold.

To date, the Federal Government has only threatened a prohibition in the case of the contemplated acquisition of *Leifeld Metal Spinning* by the Yantai Taihai Group (China), whereupon the transaction was abandoned. Nevertheless, orders have been imposed in several cases, which might concern, for example, a prohibition of relocation or veto rights by the *Bundesministerium für Wirtschaft und Energie* (BMWi).

So far, the BMWi has only been permitted to prohibit acquisitions or issue orders when an investment endangers public order or security in the Federal Republic of Germany. This required a factual and sufficiently serious risk for basic interests of the society. This comparatively high threshold was replaced by the lower requirement of an "anticipated impairment of public order or security."

- Further, various grounds for prohibition, flanking the stand-still obligation, need to be observed. In order to prevent a *de facto* implementation of the transaction, as far as it undermines the sense and purpose of the investment review laws, the last amendment to the AWG introduced several prohibitions. These prohibitions apply until the investment review procedure has been terminated.

- In particular, the acquirer may not have target company information disclosed to it that are relevant for the review of potential risks or the non-disclosure of which has been ordered by the BMWi. According to the justification statement of the amendment, such information includes in particular information the sharing of which was to be prevented through the mechanisms of investment review. This restriction on disclosure of information should be taken into account, as a matter of precaution, when carrying out due diligence in the future. Furthermore, an acquirer is also prohibited from exercising voting rights, whether directly or indirectly. This includes accepting voting instructions and may therefore need to be considered in the context of relevant covenants in the purchase agreement. Violations of these prohibitions can be punished with up to five years in prison or with fines.

But even if there is no notification obligation, an investment may be nevertheless subject to a review *ex officio* and, therefore implications on the transaction should be considered. This applies, in particular, to acquisitions of 25 % or more of the voting rights of target companies that could be considered as strategically important by the Federal Government, based on their activities or their connection to government bodies. A special focus here is also – in line with the "Industry Strategy 2030" of Economics Minister Peter Altmaier – on companies that can be relevant to Germany's "technological sovereignty". Of relevance is also the identity of the purchaser. There is skepticism, above all, regarding acquisitions by enterprises which are owned, controlled or funded by foreign states. In such situations it may be advisable to apply for the issuance of a certificate of non-objection (*Unbedenklichkeitsbescheinigung*) before signing, in order to gain legal certainty early on. Further, in such situations similar provisions on process, risk allocation etc. should be considered when drafting the purchase agreement.

Conclusion

Due to the introduction of the stand-still obligation, it should be a standard process for all M&A transactions to examine whether a transaction may be subject to notification obligation, and as consequence also to a stand-still obligation. If this is missed, the acquisition may be invalid. Even though there are parallels to the merger control process in this respect, the fact that the criteria are different must be considered. Whereas the duty to notify with the merger control authorities depends on the sales of the companies involved, the application of the investment review laws depends, independently of sales, on the place of residence of the (direct or indirect) purchaser and the activities of the target company.

As regards the latter, another expansion of the scope of foreign investment review is under way. The Federal Government is currently coordinating another amendment to the AWV. According to the initial plans of the BMWi, the catalogue of sensitive areas shall be expanded to areas like biotechnology, semiconductors, artificial intelligence, quantum technology and robotics.

Finally, for transactions with an international dimension, it is also important to consider that more and more countries are introducing investment review laws.

tim.kaufhold@pplaw.com | daniel.wiedmann@pplaw.com

About the authors:

Dr. Tim Kaufhold is attorney at law in the Munich office of P+P Pöllath+Partners. His specialty is advising on Private Equity and M&A transactions.

Daniel Wiedmann, LL.M. (NYU) is attorney at law in the Frankfurt office of P+P Pöllath+Partners. He advises on antitrust law, including merger control, and on foreign trade law.