

Germany amends Foreign Trade Law – On the road to protectionism?

TRADE ASSOCIATIONS CRITICISE THE NEW LAW FOR GOING TOO FAR

Executive Summary

- The planned amendments to the Foreign Trade and Payments Act (AWG) and the Foreign Trade and Payments Ordinance (AWV) will make foreign investments primarily in the areas of critical infrastructure (including energy, information technology and health) and critical technologies (e.g., artificial intelligence, cybersecurity and biotechnologies) subject to much higher hurdles than before.
 - The new measures to be introduced particularly concern cross-sectoral investments: for share acquisitions of more than 10% of the voting rights, there will be a civil law prohibition on closing transactions for as long as the investment screening process is ongoing; the violation of the closing prohibition is becoming subject to criminal and regulatory sanctions. In addition, the Federal Ministry for Economic Affairs and Energy's (BMWi) screening standards will be adapted to lower the threshold for state intervention and prohibitions on foreign investment significantly.
-

A. Introduction

On 8 April 2020, the German government adopted the amendment to the Foreign Trade and Payments Act (AWG). The changes aim to tighten up the previously rather liberal foreign trade laws in order to protect essential German and European security interests. These essential security interests include above all the protection of so-called critical infrastructure in fields such as energy, information technology and health.¹ The current coronavirus crisis has highlighted the government's need to protect and secure the country's supply with vital goods and medical equipment including vaccines. One incident pointing this out was, for example, the United States' announced plan to acquire exclusive rights to the COVID-19 vaccine from the Tübingen-based vaccine manufacturer CureVac.

The main reason for the amendment to the Foreign Trade Act was, however, the implementation of the EU foreign investment screening regulation (Regulation (EU) 2019/452 of 19 March 2019)², which will be binding for all member states from 11 October 2020 onwards. The so-called EU Screening Regulation creates a cooperation mechanism between Member States as well as between the Member States and the Commission, according to which all of these can influence foreign direct investment in a Member State if there is reason to fear

¹ BMWi website on the AWG amendment (in German), available at <https://www.bmwi.de/Redaktion/DE/Artikel/Service/Gesetzesvorhaben/erstes-gesetz-aenderung-aussenwirtschaftsgesetz.html>

² REGULATION (EU) 2019/452 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, available at <https://eur-lex.europa.eu/eli/reg/2019/452/oj>



an impairment of security or public order within the EU. To this end, the amendment also demands that a “National-Contact-Point” for the new EU-wide cooperation mechanism be established in each Member State; for Germany, this will be at the BMWi.³



In accordance with the EU Screening Regulation, the planned amendments to the Foreign Trade Act (AWG) intend to increase protection, especially of critical infrastructures. In more concrete terms, this is to be achieved by expanding the scope of the examination of a specific threat to include a likely impairment of EU public security or public order compared to a threat only the national public security or public order in any one state. The consequences for the legal effectiveness of a share purchase and transfer agreement with regard to a cross-sector investment are also significant. Although contracts under the law of obligations were already subject to the condition subsequent of authorities prohibiting the transaction, the contract under the law of obligations was in principle effective from the beginning and did not prevent the parties from effectively closing the contract and thus transferring ownership rights. However, the BMWi’s draft bill now stipulates that in the future, any legal transaction aimed at closing will be provisionally invalid and that indirectly transferring shareholder rights such as the right to exercise voting rights, receiving claims to profit distribution by means of the transfer of economic

³ BMWi website on the AWG amendment, loc.cit.

equivalents or providing security-relevant information to the acquirer are also expressly prohibited. Violations will be subject to criminal and regulatory sanctions.

Due to the risks for foreign investors resulting from the amendment – especially in the area of critical infrastructures and technologies –, investors and their advisers should address reporting and examination obligations regarding the planned acquisition and further steps such as the application for a clearance certificate as early as possible (preferably at the beginning of the due diligence).

B. Which acquisitions are affected?

The Foreign Trade and Payments Ordinance (AWV) determines which acquisitions are subject to reporting requirements and screening. It distinguishes between cross-sectoral and sector-specific investments.

Cross-sectoral investments basically concern all acquisitions of companies through which an investor based outside the EU or the EFTA area acquires at least 25% of the voting rights in a German company (Sections 55 Subsection 1 Sentence 1, 56 Subsection 1 No. 2 AWV). A lower threshold of 10% and a general reporting obligation applies to cross-sector investments in companies that are considered to be part of a security-relevant sector (Sections 55 Subsection 1 Sentence 2, 56 Subsection 1 No. 1 AWV). This includes in particular companies operating critical infrastructures within the meaning of the Act on the Federal Office for Information Security (BSIG). Operators of critical infrastructure are primarily defined as companies from the energy, water, food, information technology, health, finance and insurance, transport and traffic, and media sectors once certain thresholds are met. In Germany, cross-sector investments can be reviewed by the BMWi to determine whether they pose a danger to security and public order.

A sector-specific investment is defined as the acquisition of a company active in a particularly security-sensitive area such as armaments production or military IT development. A sector-specific investment by foreigners (including from an EU country) is subject to a general



notification obligation and investment screening if at least 10% of the voting rights are going to be acquired. Sector-specific investments are reviewed by the BMWi to determine whether the acquisition of shares puts Germany's essential security interests at risk.

The amendment of the Foreign Trade Act (AWG) and the already announced amendment of the Foreign Trade Ordinance (AWV) primarily concern cross-sectoral investments.

C. The planned amendments in detail

The main changes to the Foreign Trade Act (AWG) amendment are:

I. Investment screenings are expanded

The BMWi draft law provides for a significant expansion of the scope of the screening. By adjusting the scope of investment screenings, the government hopes to be able to "examine critical company acquisitions more proactively in the future"⁴.

At present, the BMWi is essentially examining foreign investments as to whether there is "an actual and sufficiently serious danger" within the meaning of Section 5 Subsection 4 Sentence 2 AWG. According to Section 5 Subsection 2 Sentence 1 of the new version of the AWG, the screening will now focus more on whether public order or security are "likely to be adversely affected" as a result of the acquisition.⁵ The adapted wording of the new Section 5 AWG drastically expands the scope of government screening and leeway in its decision-making in two respects: on the one hand, the

threshold of mere "impairment/adverse effect" is significantly lower than that of a "threat" and, on the other hand, the actual existence of a threat as a result of an acquisition is no longer relevant, but rather its hypothetical effects in the future.

Moreover, investment screenings will no longer be limited to considering only national security interests. Sections 4 Subsection 1 No. 4, 4a of the new version of the AWG state that investments must also be examined for affecting the "public order or public security of another Member State" and "projects or programmes of Union interest".⁶

This expansion of the scope of investment screening significantly lowers the threshold for future government intervention in the form of orders or prohibitions.

II. Share purchase and transfer agreements may not be executed

Although the conclusion of a contract for the purchase of shares under the law of obligations, which qualifies as a cross-sector investment, is effective from the outset as per Section 15 Subsection 2 AWG, it is subject to the condition subsequent that the authorities may prohibit it and, in this case, it may have to be reversed. This regulation until now allowed an effective execution and transfer of ownership of company shares even if the final screening result was not yet available. However, Section 15 Subsection 3 of the amended AWG now stipulates that in the future all legal transactions aimed at the closing of an acquisition of shares are provisionally invalid if the BMWi has a right to screen the transaction and if the investment is subject to the notification obligation.⁷ This affects all investments in security-relevant sectors (e.g., operators of critical infrastructures) that involve at least 10% of the voting rights (Sections 55 Subsection 1 Sentence 2, Subsection 4, 56 Subsection 1 No. 1 AWG).

⁴ BMWi press release of 08 April 2020 (in German), available at <https://www.bmwi.de/Redaktion/DE/Pressemitteilungen/2020/202004/08-altmaier-investitionen-in-sicherheitssensiblen-bereichen-koennen-umfassender-und-vorausschauender-geprueft-werden.html>

⁵ Draft law of the Federal Government of 31 February 2020, First Act amending the Foreign Trade and Payments Act and other laws (in German), available at https://www.bmwi.de/Redaktion/DE/Downloads/E/erstes-gesetz-zur-aenderung-des-aussenwirtschaftsgesetzes-gesetzentwurf.pdf?__blob=publicationFile=4

⁶ Draft law of the Federal Government of 31 February 2020, loc. cit.

⁷ Draft law of the Federal Government of 31 February 2020, loc. cit.



As a result, an investor wishing to acquire at least 10% of the voting rights in a company that operates what is considered critical infrastructures cannot acquire ownership of the shares until the BMWi has completed the investment screening and the acquisition has been approved. In the case of cross-sectoral investments, the BMWi will communicate its decision after a maximum of four months after receipt of the complete documents. As a result, the contracting parties are left to deal with some uncertainty about the effectiveness of the acquisition – possibly for months.

In addition, Section 15 Subsection 4 of the amended AWG also prevents a *de facto* closing by the parties, by prohibiting and sanctioning indirectly transferring shareholder rights such as the right to exercise voting rights, receiving claims for the payment of dividends through an economic equivalent and providing security-relevant information to the acquirer.⁸ In the future, especially the disclosure of security-relevant information will become relevant as early as the due diligence stage of a transaction.

III. Sanctions

Violating the prohibitions under the amended Section 15 Subsection 4 AWG may in the future be punished under the amended Section 18 Subsection 1b AWG by imprisonment for up to five years or a fine. Anyone acting negligently will be committing an administrative offence and faces a corresponding fine.⁹

D. Outlook: amendment of the Foreign Trade Ordinance (AWV)

The BMWi has already announced that the amendment of the Foreign Trade and Payments Act (AWG) will be followed by an amendment of the Foreign Trade and Payments Ordinance (AWV). The BMWi intends to present a draft for this in a few weeks' time.¹⁰ The

⁸ Draft law of the Federal Government of 31 February 2020, loc. cit.

⁹ Draft law of the Federal Government of 31 February 2020, loc. cit.

¹⁰ Strengthening of the national investment screening law, main contents of the first part of the amendment to the Foreign Trade Act,

amendment of the AWV will include in particular the conceptual expansion of “security-relevant sectors” in accordance with Article 4 of the EU Screening Regulation. As a result, an even wider range of industries and sectors will face the fact that the execution of the transaction will be *de facto* prohibited as long as an investment screening process is ongoing.



In its draft bill on the amendment to the AWG, the BMWi explains: “Especially Article 4 of the EU Screening Regulation makes it clear that the relevance of the investment screening can go beyond (national) security, insuring vital supplies to the population and critical infrastructure. The ‘critical technologies’ referred to in Article 4 Subsection 1 letter b of the EU Screening Regulation play a central role in this respect.”¹¹

According to this, the AWV amendment is intended to extend the screening programme of security-relevant sectors according to Section 55 Subsection 1 Sentence 2 AWV in any case to include critical technologies, which includes in particular technologies relating to artificial

BMW of 30 January 2020 (in German), available at https://www.bmwi.de/Redaktion/DE/Downloads/J-L/kerninhalte-des-ersten-teils-der-nouvelle-des-aussenwirtschaftsrechts.pdf?__blob=publicationFile=4

¹¹ Explanatory memorandum to the draft law of the Federal Government of 31 February 2020, First Amendment of the Foreign Trade and Payments Act and other laws (in German), available at https://www.bmwi.de/Redaktion/DE/Downloads/E/erstes-gesetz-zur-aenderung-des-aussenwirtschaftsgesetzes-gesetzentwurf.pdf?__blob=publicationFile=4



intelligence, robotics, semiconductors, cyber security as well as nanotechnologies and biotechnologies.

However, the BMWi's statement also mentions the intention to adapt the catalogue of security-relevant sectors in Section 55 Subsection 1 Sentence 2 AWV as far as possible to the screening programme of Article 4 of the EU Screening Regulation. In addition to critical technologies, it should be noted that in the area of critical infrastructure, Article 4 of the EU Screening Regulation also includes "investments in land and real estate crucial for the use of such infrastructure".¹² It is therefore to be expected that land transactions that really only concern critical infrastructures or critical technologies indirectly may also be subjected to the reporting obligation and thus fall into the category of transactions whose execution will be prohibited.

E. Impact on future M&A transactions

Before the planned amendments to the AWG can be applied, the BMWi's draft must pass the parliamentary legislative procedure in Germany. As the EU-Screening-Regulation will be binding for all Member States as of 11 October 2020, it is expected that the amendments to the AWG (and possibly the AWV) will become effective at the same time.

In summary, cross-sector acquisitions in Germany by a foreign investor (outside the EU) of at least 10% of the voting rights in a company that is considered to be part of a security-relevant sector within the meaning of Section 55 Subsection 1 Sentence 2 AWG will be subject to reporting requirements and will be prohibited from closing the transaction as long as screening process is underway.

In order to avoid potentially many months of costly delays due to an ongoing investment screening, investors would do well to report a transaction to the BMWi at the earliest possible stage and to apply for a

clearance certificate within the meaning of Section 58 AWV, which is deemed to have been granted at the latest two months after the application.

It remains to be seen how especially the newly introduced ban on closing and the lowered threshold for state intervention in transactions will affect foreign investors in Germany. However, it may be expected that the planned conceptual expansion of security-relevant sectors in the already announced AWV amendment to include further areas such as critical technologies and also transactions only indirectly affecting such sectors will significantly reduce the attractiveness of German companies as targets for foreign investors.

This is particularly true for venture capital investments. The German Private Equity and Venture Capital Association (BVK) has already warned the amendments could prove to be an obstacle to future investments in German technology companies and an "exit brake" on their sale. Together with other associations, BVK has therefore called for the closing prohibition to be limited to sectors that are actually crucial to security and public order, such as critical infrastructures, and demands that transparent and narrow requirements be set for the definition of a threat to public safety and order whose fulfilment triggers this prohibition.¹³

Andreas Bauer, LL.M.

Attorney-at-Law (Germany)
Munich
andreas.bauer@gsk.de

Elisabeth Kreitmair

Attorney-at-Law (Germany)
Munich
elisabeth.kreitmair@gsk.de

¹² REGULATION (EU) 2019/452 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 19 March 2019, op. cit.

¹³ German Private Equity and Venture Capital Association (BVK) website, available at <https://www.bvkap.de/en>



Copyright

GSK Stockmann – all rights reserved. The reproduction, duplication, circulation and/or the adaption of the content and the illustrations of this document as well as any other use is only permitted with the prior written consent of GSK Stockmann.

Disclaimer

This client briefing exclusively contains general information which is not suitable to be used in the specific circumstances of a certain situation. It is not the purpose of the client briefing to serve as the basis of a commercial or other decision of whatever nature. The client briefing does not qualify as advice or a binding offer to provide advice or information and it is not suitable as a substitute for personal advice. Any decision taken on the basis of the content of this client briefing or of parts thereof is at the exclusive risk of the user.

GSK Stockmann as well as the partners and employees mentioned in this client briefing do not give any guarantee nor do GSK Stockmann or any of its partners or employees assume any liability for whatever reason regarding the content of this client briefing. For that reason we recommend you to request personal advice.

www.gsk.de

GSK Stockmann

BERLIN

Mohrenstrasse 42
10117 Berlin
T +49 30 203907-0
F +49 30 203907-44
berlin@gsk.de

HEIDELBERG

Mittermaierstrasse 31
69115 Heidelberg
T +49 6221 4566-0
F +49 6221 4566-44
heidelberg@gsk.de

FRANKFURT / M.

Taunusanlage 21
60325 Frankfurt am Main
T +49 69 710003-0
F +49 69 710003-144
frankfurt@gsk.de

MUNICH

Karl-Scharnagl-Ring 8
80539 Munich
T +49 89 288174-0
F +49 89 288174-44
muenchen@gsk.de

HAMBURG

Neuer Wall 69
20354 Hamburg
T +49 40 369703-0
F +49 40 369703-44
hamburg@gsk.de

LUXEMBOURG

GSK Stockmann SA
44, Avenue John F. Kennedy
L-1855 Luxembourg
T +352 271802-00
F +352 271802-11
luxembourg@gsk-lux.com



YOUR PERSPECTIVE.

GSK.DE | GSK-LUX.COM