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## MERGERS AND ACQUISITIONS

### GERMAN GOVERNMENT KICKS OFF SERIES OF REFORMS AIMED AT FURTHER TIGHTENING THE GERMAN FOREIGN INVESTMENT CONTROL REGIME

In a cabinet resolution dated 20 May 2020, the German Federal Government adopted the 15th amendment to the German Trade and Payments Ordinance and thereby kicked off an expected series of legislative changes in 2020 to further tighten the rules governing foreign investments in Germany. This first reform is related primarily to the COVID-19 pandemic and seeks to intensify governmental control over acquisitions of German target companies active in the health care and infection protection sectors, in particular by lowering control thresholds and introducing additional notification duties. The amendment will enter into force very shortly and affect all relevant transactions that have not been closed on the date of the reform's entry into force.

#### Comprehensive foreign investment control regime under current German law

German foreign investment control is governed by the Foreign Trade and Payments Act (Außenwirtschaftsgesetz – “AWG”) and the Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung – “AWV”) and has already been the subject of several legislative reforms over the past three years, all aiming at the tighter control over foreign investments.

- › What is known as **sector-specific foreign investment control** applies to (direct or indirect) acquisitions by any foreign investor of at least 10% of the voting rights in German target companies active in particularly sensitive industry sectors, such as the manufacture or development of war weapons/military equipment and encryption technology. The completion of foreign investments of this kind is subject to the statutory condition precedent of the approval of the Federal Ministry of Economics and Technology (Bundeswirtschaftsministerium – “BMWi”).
- › Irrespective of the relevant industry, (direct or indirect) acquisitions reaching or exceeding certain shares in voting rights in German target companies by non-EU/EFTA investors are subject to **cross-sector foreign investment control**. The BMWi may review, restrict or even prohibit such an acquisition if it poses a threat to public order or security. To this end, the acquisition agreement is subject to a statutory condition subsequent of the BMWi prohibiting the intended acquisition. There are two different thresholds within the cross-sector foreign investment control regime: Foreign investments in German target companies active in certain **civilian security relevant industries**, such as critical infrastructures (currently including energy, water, food, telecommunications, transport, finance, insurance and healthcare), can be controlled by the BMWi if 10% or more of the voting rights are acquired; in these cases, a mandatory notification requirement applies (“**Notifiable Acquisitions**”). All other foreign investments in German target companies are merely subject to a 25% threshold, and such acquisitions neither require regulatory approval nor do they need to be notified to the BMWi.

Thus, so far only a rather limited number of German target companies active in the healthcare sector qualify as operators of critical infrastructures (including, *inter alia*, hospitals, laboratories, manufacturers of and facilities/systems for selling prescription drugs as well as manufacturers of respiratory equipment exceeding certain sizes in each case) and are subject to the stricter rules that are applicable to Notifiable Acquisitions.

#### Expanded scope of Notifiable Acquisitions to the healthcare and infection protection sectors

The 15th amendment to the AWW, adopted by the German Federal Government on 20 May 2020 and about to enter into force, marks the beginning of what is expected to be a series of legislative reforms to tighten the rules and expand the scope of the German foreign investment control regime. Triggered by the COVID-19 pandemic and driven by fears of potential comparable crises in the future, the German Government has taken the view that the current cross-sector foreign investment control regime is insufficient to secure a fully functional healthcare system in Germany in the long term. The 15th AWW amendment therefore expands the scope of Notifiable Acquisitions to cover foreign investments in a broad range of German target companies active in the healthcare and infection protection sectors. In particular, the development and manufacture of the following products are now qualified as Notifiable Acquisitions:

- › personal protective equipment;
- › pharmaceuticals essential for ensuring the provision of healthcare to the German public (including the relevant raw materials and active ingredients);
- › medical devices intended for the diagnosis, prevention, monitoring, prediction, prognosis, treatment or alleviation of life-threatening and highly contagious infectious diseases; and
- › in-vitro diagnostic medical devices used to provide information on physiological or pathological processes or conditions or to determine or monitor therapeutic measures in connection with life-threatening and highly contagious infectious diseases.

### **Additional changes to the German foreign investment control regime**

The German Federal Government has taken the latest amendment of the AWW as an opportunity to expand the scope of Notifiable Acquisitions in other respects as well. In the future, Notifiable Acquisitions will additionally include foreign investments in German target companies that provide services in relation to state communication infrastructures (i.e. a digital voice and data transmission system for authorities and organizations with security functions). In conducting its review, the BMWi is now explicitly also entitled to take into account whether a foreign investor is state-owned or state-controlled or the investment is state-financed. Finally, the 15th AWW amendment explicitly clarifies that asset deals are also subject to the control by the BMWi, which reflects the current administrative practice.

These further amendments to the German foreign investment control regime do not relate to the COVID-19 pandemic. Rather, for the most part they anticipate the implementation of Regulation (EU) 2019/452 of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union ("**EU Screening Regulation**").

### **Further tightening of German foreign investment control upcoming**

The 15th AWW amendment is only the first step in a series of legislative changes to the German foreign investment control regime which are expected to be enacted in the coming weeks or months. In particular, a draft bill for the amendment of the AWG has already been adopted by the Federal Cabinet and is currently passing through the parliamentary process. Furthermore, the Federal Government is planning an additional reform of the AWW once the legal basis in the AWG has been amended. Both of these upcoming legislative steps will include further regulatory details for implementing the EU Screening Regulation.

The most important changes expected for the very near future again relate to Notifiable Acquisitions: The scope of this category of transactions will be further expanded to cover foreign investments in German companies, which are active in the areas of so-called critical technologies, in particular artificial intelligence, robotics, semiconductors, biotechnology and quantum technology. In addition and most importantly, the completion of any Notifiable Acquisition will be subject to a statutory condition precedent of the BMWi's approval of the transaction. This will be coupled with a prohibition of implementing the Notifiable Acquisition before the BMWi has granted approval and backed by criminal sanctions.

Furthermore, the review standard under the cross-sector foreign investment control regime will be materially relaxed. In the future, the BMWi will be entitled to restrict or prohibit an acquisition if it merely "potentially impairs" public order or security of Germany or another Member State, as opposed to the current requirement of a serious threat to public order or security.

### **Gleiss Lutz commentary – Implications for cross-border M&A**

The 15th amendment of the AWW adopted on 20 May 2020 will have a material impact on cross-border M&A involving German target companies active in the sectors of healthcare and infection protection. Acquisitions of

targets that develop or manufacture certain vaccines, pharmaceuticals (including raw materials and active ingredients) and medical devices for the treatment of highly contagious infectious diseases will now be subject to the review powers of the BMWi once the 10% threshold of voting rights is reached or exceeded. Furthermore, such transactions will need to be notified to the BMWi. Thus, the BMWi will also be made aware of and able to review acquisitions of smaller minority stakes in many German health care companies. We expect that, on this basis, the BMWi will also further tighten its administrative practice and may make increasing use of its restrictive and prohibitive powers in the business sectors of healthcare and infection protection. Consequently, M&A workflows in the sectors of healthcare and infection protection will need to analyze in detail the specific business operations of the German target company, the acquirer and possible security concerns so as to take due account of the requirements and risks posed by German foreign investment control.

In this context, it is also noteworthy that the scope of Notifiable Acquisitions proposed in the initial draft bill of the 15th amendment of the AWP compiled by the BMWi was even more extensive: Not only were foreign investments in German target companies which directly develop or manufacture the above-listed products to be notified to the BMWi, but in many cases also foreign investments in those companies which are only indirectly involved in these processes, such as suppliers of raw materials and active ingredients, intermediate products and components. Although the 15th amendment of the AWP does not go quite that far, this legislative history may well provide indications as to which foreign investments the BMWi will be scrutinizing more closely in the future, even outside of the scope of Notifiable Acquisitions.

While the 15th AWP amendment plays a significant role for cross-border M&A in the areas of healthcare and infection protection, the upcoming reforms of the AWG and the AWP will have a much broader and more fundamental impact on M&A practice involving German target companies. For international investors, a detailed risk analysis under German foreign investment control law will become more crucial than ever in order to avoid obstacles to closing, unexpected delays in the deal schedule and even criminal sanctions for violating gun-jumping prohibitions. This is also true for pending transactions that have not yet been closed by the time of the entry into force of the relevant legislative changes and are therefore caught by the new, stricter rules. In such cases, the relevant legal situation should be assessed thoroughly before closing.

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