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Germany's first veto against a foreign investment under new FDI rules

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On 1 August 2018, the German government was set to block a foreign investment in a German company under the new foreign direct investment (FDI) screening rules for the first time. However, the veto was not required as, on the same day, the Chinese investor withdrew from the deal.

Companies involved in M&A activities will be familiar with the process for notifying their transactions to competition authorities across the globe. Increasingly, they also need to be aware that some jurisdictions also have FDI screening mechanisms. Whereas merger control reviews investments from a competition perspective, foreign direct investment screenings are designed to protect the state's "essential interests", a considerably more amorphous concept.

The deal

The target, Leifeld Spinning Metal AG ("Leifeld") specialises in metal forming in a number of industries, including automotive, chemicals, aerospace and the nuclear industry. The proposed Chinese investor, Yantai Taihai Corp., manufactures, inter alia, equipment for nuclear power plants.

No information is available as to the German government's precise concerns. Its FDI screening regime enables a transaction to be blocked only for reasons of "risk to public order and safety".

The scope of Germany's FDI screening rules

FDI screening is not unusual in Germany. According to press reports, since the revised mechanism was introduced in July 2017, more than 80 cases have been investigated, one third of which are said to have involved investors from China.

FDI screening is divided into sector-specific and cross-sector review.

Sector-specific review covers the defence industry and specific IT-security companies that are e.g. involved in cryptography for government classified information. Sector-specific review applies even if the foreign investor is based in the EU.

The *cross-sector review* can catch any other transaction involving non-EU investors that propose to acquire at least 25% of the voting rights of the target.

Cross-sector review is not restricted to particular industries or sectors, nor does the German legislation provide guidance on industries or sectors that are likely to be of particular interest. In seeking to get a sense of where German concerns are likely to lie, the legislative initiative of the European Commission for an EU FDI Regulation may provide useful guidance. On this basis, investors considering investments in regulated industries (energy, transport, telecoms etc.), data-related industries, new technologies (AI, robotics etc.), semiconductors, technologies with potential dual-use applications (i.e. which can be used for both military and civil purposes), cybersecurity and similarly critical sectors may want to have a closer look at Germany's FDI rules. The European Parliament's draft considers that the Commission's list should be extended to include amongst others shipyards, media, ICT, automotive and R&D, which suggests that no investment is safe.

Notify or risk review at any time within 5 years

Investments in specific sectors that that lead to direct or indirect control of at least 25% of voting rights by a foreign investor must be notified.

If a company subject to sector-specific review has filed its notification, the authorities have 3 months to open an in-depth investigation. The validity of a specific-sector transaction depends on the authorities' approval.

Cross-sector investments have to be notified only if they involve critical infrastructures (and certain related services and goods like operating software). Critical infrastructures include (parts of) facilities or, systems in the energy sector, IT/telecommunications, transport/haulage, health, water, nutrition and financial and insurance sector that meet certain legal thresholds. In general, such an infrastructure can be considered as critical if it supplies at least 500,000 individuals.

In cross-sector cases that do not involve critical infrastructure, there is no filing obligation. However, parties may apply to the Federal Ministry of Economics and

Technology (BMWi) for a comfort letter, although there is no obligation to do so.

In all cases subject to cross-sector review, the BMWi can open an investigation within three months of becoming aware of a transaction. If an application has been made for a comfort letter, any investigation must be commenced within two months of the application being made. If the BMWi is not (made) aware of a transaction, it can still intervene at any time within the next 5 years. Unlike in specific sector cases, there is no stand-still obligation in cross-sector cases, i.e. the transaction may be closed without FDI clearance. However, if the BMWi subsequently investigates a closed transaction, demerger may be ordered.

If the BMWi decides to open an in-depth investigation, it has to reach a final decision within 4 month in cross-sector cases and 3 months in specific sector cases, although time does not start to run until after the BMWi has received complete documentation. As in merger control, investigations can be concluded by offering remedies to address the government's concerns. Remedies may include guarantees to protect industrial sites or to ensure the going-concern of specific production branches.

The broader EU perspective

FDI is a hot topic in the EU right now. In 2017, 12 out of 28 EU Member States already had national FDI procedures in place, involving screenings of different intensities and with differing scope. Like Germany, Italy revised its FDI screening regime in 2017. France had already extended its screening mechanism in 2014, which it amended in 2017. Yet further reforms are currently under consideration. The UK published a White Paper on reforming its screening powers and procedures on 24 July 2018.

On 9 September 2017, the EU Commission presented a draft regulation for the screening of foreign direct investments into the European Union. Although it noted that foreign investors currently face legal uncertainty in the EU due to the fragmentation of FDI screening at Member State level (see Commission Staff Working Document), the draft regulation is not designed to solve this problem. It does not require all Member States to establish a harmonised FDI screening process but provides a framework that focuses on coordination and cooperation between Member States and the EU Commission. At its core is an information exchange system on FDI transactions, requiring mutual consideration of affected national or EU-interests in the assessment of FDIs.

Taking into account the European Parliament's draft resolution and the political interest in FDI, it does not seem likely that the EU Commission's original proposal will remain unamended. The regulation has been identified as priorityby the EU Commission, Council and Parliament and it may be enacted before the next elections in May 2019.

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