New Boundaries for the Infrastructure M&A sector: German government approves draft regulation aimed at the further tightening of Foreign Direct Investment Control

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The overall ongoing trend in major Western economies of tightening Foreign Investment Control is not being overlooked in Europe. As these new measures also particularly affect disposals and acquisitions of German "critical infrastructure" assets, infrastructure investors should be well aware of the related implications in order to structure processes and underlying timelines accordingly.

Taking a closer look at Germany over the past three years, the German government has introduced many changes to FDI regulations, the most recent being the draft bill to reform the Foreign Trade and Payments Act (see link here) which was approved by the German government on 8 April 2020 and is expected to be voted on in Parliament soon.

Historically, complex German sectors like critical infrastructure and critical technology are subject to closer scrutiny regarding Foreign Direct Investment Control. “Critical infrastructure” represents the sectors of energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure and land, as well as real estate. The fields of artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear technologies as well as nano- and biotechnologies are covered by the term “critical technologies”.

German draft bill targets three main areas

With the newly issued draft bill, the German Federal Ministry for Economic Affairs and Energy (*Bundesministerium für Wirtschaft und Energie* – BMWi) aims to introduce further amendments to the German Foreign Trade and Payments Act (*Außenwirtschaftsgesetz* – AWG) in three main areas:

Firstly, the threshold for the standard of review by the BMWi would be lowered by changing the requirement from actual endangerment of public order and security to “*likely to affect public order or security in Germany*”. This change significantly lowers the threshold for the BMWi to intervene and review an FDI transaction.

Secondly, the scope of FDI review is to be extended from security interests of only Germany to interests of “*public order and security of other Member States or projects and programmes of Union*”. This has the effect of an even broader scope for the BMWi to enter into FDI reviews *ex officio*.

Thirdly, a procedural change will be introduced by extending the scope of a stand-still obligation to all transactions subject to mandatory review in Germany. To date, the obligation only applied to mandatory reviews in sector-specific transactions, mainly in the area of defence. This amendment will impact all transactions, specifically the critical infrastructure and critical technology sector, which will be provisionally invalid prior to the final clearance by the German government. Infringements on the stand-still obligation would trigger severe consequences, including under criminal law.

Maintaining technological sovereignty

This reform is not unexpected as the changes to the current German FDI regulations are based on the EU FDI Framework Regulation (EU) 2019/452 of 19 March 2019. Due to this Regulation a new contact unit for the cooperation mechanism between Germany and the European Commission, as well as other Member States, must also be established at the BMWi. However, in light of the COVID-19 crisis, senior EU officials such as Trade Commissioner Phil Hogan have already called upon Member States to cooperate in screening transactions prior to the official application of the EU rules in autumn 2020.

At a German level, an even stricter approach to screening transactions can already be noticed since the outbreak of the COVID-19 crisis. The government closely monitors if transactions appear to be merely a "shopping tour" by non-European investors on the hunt for cheap target companies due to current financial difficulties.

The necessary amendments to the AWG, as a result of the EU FDI Framework Regulation, also require further changes to the German Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung* – AWV). A draft bill of the AWV is expected follow very shortly after the Foreign Trade and Payments Act reform.

Practical consequences for Infrastructure Investors

As a consequence of the upcoming amendment to the AWG, non-EU infrastructure investors will have to take German and EU FDI regulations into account as the screening of takeovers in the field of critical infrastructure such as energy, electricity, water, or telecommunications is permissible under both EU and German Law.

Infra investors should, however, particularly consider the significant potential time impact of the new stand-still obligation on the period between signing and closing of a transaction. Presently, the mandatory FDI notification to be furnished on the BMWi and its review process, have no direct impact on the deal time-line. A result of this procedural change will be the substantive impact on the timing of concerned deals which cannot be closed prior to final clearance by the German government. Parties involved in such transactions will have to deal with this procedural element with regards to their time-line for closing the deal.

Parties to future infrastructure M&A deals with German entities and assets will also have to be aware of a possible screening procedure because of the extension of the review scope to European public order and security interests as well as the lowering of the threshold for *ex officio* review by the BMWi. With these new regulations, it will likely become far more difficult to predict decisions of the German government and the impact on transactions in the critical infrastructure sector, which in turn leads to additional uncertainty with regard to potentially frustrated transaction costs.

To conclude, with the amendments the content of the assessment will change and they will most likely impact countless time-lines in infrastructure M&A deals within the fields of critical infrastructure and technologies. Taking into account the many more possibilities for national authorities to affect and control mergers in order to ensure public order and security, new uncertainties will inevitably also arise for investors and companies.

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