THE GLOBAL TRADE LAW JOURNAL

Volume 1, Number 1 January–February 2024

fastcase FULL COURT PRESS

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THE GLOBAL TRADE LAW JOURNAL at $495.00 annually is published six times per year by Full Court Press, a Fastcase, Inc., imprint.

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Cite this publication as:

The Global Trade Law Journal (Fastcase)

A Full Court Press, Fastcase, Inc., Publication

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729 15th Street, NW, Suite 500, Washington, D.C. 20005
https://www.fastcase.com/

POSTMASTER: Send address changes to THE GLOBAL TRADE LAW JOURNAL, 729 15th Street, NW, Suite 500, Washington, D.C. 20005.

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The Evaluation of the German FDI Regime—Cornerstones of Potential Revisions Revealed

Mirko von Bieberstein and Lukas Nigl*

In this article, the authors discuss Germany's efforts to revise its legal framework for foreign direct investment screening.

Foreign direct investment (FDI) policies around the globe continue to adjust to the changing geo-political environment. In particular, the United States and the European Union as well as certain Member States are in the process of revising their investment screening regimes, including the introduction of new tools such as outbound investment screening and the European Foreign Subsidies Regulation. Generally, the focus of these policy adjustments is on Chinese investments.

On the EU Member State level, Germany is among the more active jurisdiction leading the initiative. In early 2023, the German government issued its China strategy, among other things focusing on the treatment of Chinese foreign investments in Germany. The strategy anticipated changes of the German FDI regime but did not include more specific statements in this regard.

In the meantime, it seems the German Federal Ministry of Economy and Climate Action (BMWK), the authority leading FDI reviews in Germany, is progressing in its efforts to revise the legal framework for FDI screening in Germany. An outline of what potential revisions could look like has now been reported in the press.[1] The following provides an overview of the cornerstones according to the press reports.[2]

Introduction of a Standalone Investment Screening Law

The FDI rules shall be consolidated into one investment screening law.

The Global Trade Law Journal / January–February 2024, Vol. 1, No. 1, pp. 89–93.

Currently, the German FDI regime is governed by various laws and ordinances. One consolidated body of rules could lead to more consistency and therefore certainty, avoiding many of the cross-references to other rules that unnecessarily complicate the application of the German FDI regime in practice.

Tighter Scrutiny for Certain Core Sectors and Critical Infrastructure

Foreign investments in sensitive sectors shall become subject to stricter regulation. This shall in particular comprise "classic" critical infrastructures as well as artificial intelligence, semiconductors, cloud computing, cybersecurity, and raw materials. In order to increase scrutiny of investments in such sectors, it is contemplated to broaden the scope of each sector and thereby addressing an increasing number of transactions. Further, the BMWK will assess whether additional specific sensitive sectors shall be introduced to the FDI rules in order to protect German and European security interests.

The German FDI regime already defines 20-plus sensitive sectors investments into which non-EU investors can trigger a mandatory FDI filing and increased scrutiny. However, some of the relevant activities are defined rather narrow. For example, not all artificial intelligence–related activities are captured by the mandatory filing regime. Rather, a mandatory filing only comes into play if a German target applies artificial intelligence very specifically, such as for cyber-attacks, imitation of individuals, or for purposes of surveillance and repressive measures.

The increase of scrutiny of foreign investments in critical infrastructures and key technology sectors clearly is a reaction to recent Chinese investment activities in Germany. In 2022, the controversial investment of COSCO in a Hamburg port freight terminal was only cleared after heated political debate. Shortly thereafter, the BMWK blocked two Chinese investments in the German semiconductor sector.

No further details have been reported on potential additional sectors being added to the mandatory filing regime. However, it would not come as a surprise if additional dual use related activities eventually make it on the list.

Shifting the Burden of Proof

For investments in certain sectors, such as quantum technology, semiconductors, and artificial intelligence, the burden of proof as to whether the investment affects security interests shall be shifted to the investor. In the future, such investments could automatically be deemed to affect public order or security, unless the investor can prove otherwise.

As in any other administrative proceeding, generally the government has to prove that the requirements for a restrictive measure are fulfilled. The plan of the BMWK to shift the burden of proof would stand in stark contrast to this principle. Also, the BMWK's assessment if and to what extent public order or security are affected is also a political and discretionary one that involves many stakeholders across several ministries and agencies. This can make it extremely difficult for investors to provide and prove facts that are sufficient to rebut the presumption of their investment affecting public order or security interests, even more so since the BMWK's assessment can also take into account potential future conduct of the investor rather than merely existing circumstances. Another question is if investments that would be subject to the presumption will have no chances to get cleared in Phase I but rather automatically trigger a longer Phase II review after the lapse of the initial Phase I review, resulting in longer and more unpredictable review periods on average.

Lower Jurisdictional Thresholds

It is further envisaged to lower the jurisdictional thresholds, exceeding of which allows the BMWK to take jurisdiction over a transaction.

The jurisdictional thresholds of the German FDI regime focus on voting rights. Currently, there are three jurisdictional thresholds that apply depending on the activity of the target business. The lowest threshold is 10 percent or more and applies to investments in particularly sensitive sectors, including, inter alia, critical infrastructures, related software, and cloud computing as well as defense and cryptography technology. The next higher threshold is 20 percent or more and applies to investments in the health care sector, certain dual-use goods activities, and key technologies such as cybersecurity, artificial intelligence, semiconductors, and robotic and quantum technologies. The highest threshold is 25 percent or more, which applies to any other not specifically defined activity (investments into which, however, do not trigger a mandatory filing but allow for ex-officio investigations of the BMWK).

It is not clear what the exact plans are, especially if those thresholds will all be lowered or if thresholds will only be lowered for certain target activities. However, it also seems to be envisaged to take into account actual attendance at general meetings of stock corporations. Attendance at these general meetings is usually below 100 percent, while the required majority for shareholder resolutions is generally calculated based on the voting rights represented in the general meeting. In consequence, shareholders who hold even less than 25 percent of the voting rights in such company could effectively have a blocking majority in a general meeting. Therefore, it may be intended to adjust the jurisdictional thresholds downward in case of companies with a rather low attendance in general meetings to reflect the effective voting power of the relevant shareholder.

The lowering of the jurisdictional thresholds would certainly increase the number of transactions reviewable by the BMWK. While taking into account effective voting power in stock companies with generally lower attendance at general meetings has a certain logic to it, this will have to be based on a look-back of attendance percentages for recent years. There will need to be clear guardrails such as a specific period for the look-back and a specified average attendance quota to avoid uncertainty as to when the jurisdictional threshold is exceeded and the BMWK has jurisdiction to review.

Expansion of the Screening Scope

It is further envisaged to expand the scope of the German FDI review beyond M&A transactions. The BMWK seems to consider to also capturing purely contractual arrangements such as license agreements in relation to intellectual property and purely contractual veto rights instead of acquiring voting shares in a company. In addition, in exceptional circumstances greenfield investments in specifically sensitive sectors shall become reviewable under the German FDI rules. Finally, the BMWK will assess if and to what extent cooperations between German research institutions (such as universities) and Chinese institutions can become reviewable under the German FDI regime.

Conclusion

Currently, the German FDI regime only covers acquisitions of a German business either through acquiring voting rights by way of a share deal (or similar transaction) or by way of asset deals, that is, transactions in which the investor acquires ownership in relevant business assets. Expanding the scope of reviewable transactions to purely contractual arrangements and even greenfield investments could close loopholes used by investors to gain access to certain sensitive information.

They are also clearly aimed at impeding market access for Chinese investors. On the other hand, it seems questionable if the FDI regime requires such expansion given other existing regulatory regimes, such as export control and subsidies regulations, may already cover this.

It remains to be seen to what extent these envisaged changes will survive the political debate.

In any case, even if only some of these cornerstones are implemented, the path to tighter FDI scrutiny is set. Even more so since this does not yet reflect an outbound investment screening regime that is currently discussed on the EU level and may eventually be implemented on national Member State level.

Notes

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1. https://www.handelsblatt.com/politik/deutschland/china-wie-habeck-den-einfluss-der-volksrepublik-begrenzen-will/29340810.html.

2. https://www.handelsblatt.com/politik/deutschland/china-wie-habeck-den-einfluss-der-volksrepublik-begrenzen-will/29340810.html; https://www.handelsblatt.com/politik/deutschland/china-geschaeft-habeck-will-investitionspruefung-verschaerfen/29342540.html; https://www.ft.com/content/1f37a5f2-0aac-4940-8071-963e967496e4.