**Webinar: Foreign direct investment in Germany and the investor status of the UK**

**Topic**: The regulation of foreign direct investment in Germany and the investor status of the United Kingdom during the Brexit transition period

**Speakers**:

* Oliver Bretz – Partner, Euclid Law
* Dimitri Slobodenjuk – Counsel, Clifford Chance Düsseldorf

**The regulation of foreign direct investment in Germany**

* In the second of the monthly discussions on foreign direct investment (“**FDI**”) hosted by Oliver, Dimitri Slobodenjuk of Clifford Chance, Düsseldorf, provided an overview of Germany’s FDI framework and its recement amendments.
* The current rules distinguish between two types of scrutiny. First, “sector specific” scrutiny, through which government analyses the proposed purchase by a non-German investor of at least 10% of the voting rights of a German target entity active in the defence or security sector. “Cross-sectoral scrutiny” involves the examination of transactions in which a non-EU investor purchases at least 10% of the voting rights of a German target entity that is active in certain critical sectors, for example infrastructure. The threshold of 25% of the voting applies to industries outside the critical infrastructure.
* Historically, cross-sectoral scrutiny was applied narrowly, and involved “classic” areas including energy, water, telecoms and so forth. However, two cases in the past 3 – 4 years triggered amendments to the FDI framework that resulted in the application of a more robust approach.
* The first concerned the acquisition of German industrial robotics firm Kuka by the Midea Group of China. The case escaped FDI scrutiny as robotics was not a critical infrastructure for the purpose of the cross-sectoral scrutiny at the time.
* The second case involved the ultimately unsuccessful attempt by a Chinse-owned company to purchase shares in 50Hertz, a German “transmission system operator”. Although State Grid’s offer fell below the 25% threshold which was applicable at that time for critical infrastructure, the German government prevented the transaction by using the state-owned bank, KfW, as a white knight to purchase shares in 50Hertz.
* These events culminated in several changes to the German FDI regime:
  + In 2018, as a result of the 50 Hertz transaction, the threshold for review of investments in critical infrastructure was lowered from a purchase of 25% of the voting rights of the target to 10%.
  + In 2020, the German government harnessed the Covid-19 momentum to widen the scope of FDI regulation to include proposed investment in German manufacturers and distributors of “essential pharmaceuticals”. The legislation is broadly worded and is not confined to Covid-era transactions.
  + Amendments of a procedural nature impose government FDI approval, where applicable, as a closing condition on a transaction. More controversially, gun-jumping is a criminal offence that can be punishable with a prison sentence of up to 5 years.
  + According to public statements of the government, the ambit of review will be extended to certain high-tech industries, which reportedly include artificial intelligence, robotics and biotechnology. The legislation has not yet been published but partly aligns with EU [Regulation 2019/452](https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019R0452&from=EN#d1e448-1-1) establishing a framework for the screening of FDI into the EU (“**EUFIS**”).
* The amendments may be seen as too far-reaching, and less intensive measures may have sufficed to achieve the goal of protecting national critical industries.
* In addition, other Member States may soon follow Germany’s lead, which raises the question of whether a proliferation of domestic FDI regimes has the potential to prevent the “one-stop-shop” in the EU. It is possible that Member States’ FDI regimes will gradually align in the next 5 – 10 years. However, this must be balanced against the different national interests at play.
* An attendee linked the potential decline of centralised merger control with the German Constitutional Court’s ECB judgment delivered on 5 May 2020. In the ensuing discussion, the judgment was briefly described as centring on the supremacy of legal orders, but how the Commission may still lead in certain projects, such as Horizon 2020 and the Trans-European Networks referred to in EUFIS. The Commission may also address particular subjects by issuing opinions.

**The investor status of the United Kingdom during the Brexit transition period**

*UK Investors*

* In [April’s instalment](https://euclid-law.eu/index.php/2020/04/14/webinar-dg-trades-carlo-pettinato-on-foreign-direct-investment-controls/) of the FDI webinar, an attendee asked whether UK investors would be treated as “foreign investors” for the purposes of EUFIS. In this session, Oliver canvassed the relevant rules and regulations with a view to answering the question in more detail.
* EUFIS defines a “foreign investor” in Article 2(2) as “*a natural person of a third country or an undertaking of a third country, intending to make or having made a foreign direct investment*”. According to the Council, the UK would be “considered as a third country” from the entry into force of the UK Withdrawal Agreement (31 January 2020 at midnight CET). It therefore appears that the UK would be considered a foreign investor.
* However, the position is complicated by the recitals in the Withdrawal Agreement, which state that during the transition period, EU law “*should be applicable to and in the UK, and, as a general rule, with the same effect as regards Member States…*” On this basis, it seems that the UK will not be treated as a “foreign investor” during the transition period, but have EUFIS applied to it in the same way as the Member States. This aligns with the positions of the German and French governments on the point.

*PE Funds established in the Channel Islands*

* This is in contrast to the treatment of UK PE Funds that are established in the Channel Islands, which stand in a different position vis-à-vis the law of the EU.
* Protocol 3 of the UK’s 1972 Accession Treaty stipulates that the Channel Islands “*were effectively part of the Customs Union and could trade in goods as if they were part of the EU*”. The Treaty is silent on other hallmarks of EU law, such as the free movement of capital.
* When read with Article 3(1)c of the Withdrawal Agreement, the EU law applicable to the Channel Islands is confined to that stated in Protocol 3. On this basis, it is likely that a PE fund established in the Channel Islands would be treated as a “foreign investor” under both EUFIS and Member State national law.
* Attendees confirmed that this is the position followed by the German and French governments. In addition, the view of the German government is that as soon as there is an SPV in the chain of ownership structure that is a “foreign investor”, the whole transaction must be notified to the German government. This would include SPVs established in Channel Islands, despite the fact that the ultimate PE fund is located in the UK.
* Similarly, hedge funds may find themselves caught by low FDI thresholds where they would not have been before. This creates a potentially new group of clients affected by FDI frameworks and the potential for missed filings.

**Discussion in response to questions**

* Germany is not alone in having enacted gun-jumping sanctions. However, it is unique in its choice of potential criminal sanctions, which raises the question of how the German government will enforce a penalty against individuals located in other countries. Monetary sanctions would likely have been a more efficient tool, and one that poses fewer enforcement complications.
* The number of suspensory regimes in force in the EU is bound to increase. This is acute in the current climate, where the states of emergency in many Member States has allowed legislation to be passed without parliamentary debate or other ordinary vetting procedures.