

## Gaining in importance

### Washington extends investment controls – will Brussels and Berlin follow suit?

By Dr. Tobias Grau and Kai Neuhaus

**M**any countries have traditionally imposed controls on foreign acquisition of domestic companies. From an official standpoint, direct investment is generally restricted out of concern for national security – but in practice the restriction often has its basis in economic interests.

The latter purpose was likely President Donald Trump’s main motive in signing the Foreign Investment Risk Review Modernization Act into law on August 13, 2018. This legislation significantly expands the powers and authority of the CFIUS (Committee on Foreign Investment in the United States), the government committee responsible for investment control. CFIUS now has until February 2020 to translate these new powers into specific rules. As a result of this relatively lengthy timeline, it will now be more difficult to plan future transactions without facing a certain level of unpredictability. Foreign investors aiming to buy US companies can undoubtedly expect to face additional hurdles.

#### Covered transactions

It is already apparent that the number of transactions subject to CFIUS scrutiny will increase significantly, given that the definition of “covered transactions” has been broadened. Some estimates put the figure at several thousand transactions a year – a load that would test the limits of CFIUS’s capacity, quite apart from any other issues. The industrial sectors subject to controls are now specified in detail. For example, transactions involving “sensitive real estate” near airports, sea-ports, US military facilities, or other facilities of significance for national security will be explicitly covered in the future. Investments involving critical infrastructure and technologies or U.S. citizens’ sensitive personal data also fall within the scope of CFIUS’s expanded authority. CFIUS has yet to set out what this means specifically. Non-controlling investments are also covered – that is, situations where the investor gains access to material non-public information, secures representation or observer rights on the company’s board, or becomes involved in substan-



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...tive decision-making without obtaining formal control. Additionally, any change in a foreign investor’s ownership rights in a US company constitutes a covered transaction if the change results in the investor gaining control, or if the change is related to critical infrastructure, critical

...technologies or sensitive personal data of US citizens. Lastly, the legislation closes previous loopholes in investment control by subjecting alternative structures, such as joint ventures or phased acquisition of equity interests, to CFIUS scrutiny.

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### Mandatory declarations

Until now, notifying CFIUS of M&A transactions has been voluntary (unless CFIUS itself initiated proceedings). In certain cases, a CFIUS review is now mandatory:

- Investments in which a foreign government has a substantial interest; “substantial interest” will be defined in the CFIUS implementing regulations”;
- Investments that result in the direct or indirect acquisition of a substantial interest in a US company related to critical infrastructure, critical technologies or sensitive personal data of US citizens.

### Extension of the review cycle

The extension of the CFIUS review from 75 to 105 days will have a direct impact on how company acquisitions are planned, as well as on contract provisions. That said, a short-form declaration process applies in certain circumstances.

### Filing fees

CFIUS is now entitled to charge filing fees, with immediate effect. The fee is 1% of the transaction value, up to a maximum of \$300,000. This represents a significant

increase in transaction costs, especially where smaller deals are concerned.

### Initial observations

While these changes to US law affect all foreign direct investment in equal measure, the Trump administration clearly wants to rein in Chinese investors in particular. Since CFIUS scrutinizes investors from certain regions – and especially from China – more closely, it has been apparent for some time that these investors are less favored by sellers in US-linked bidding procedures. Often these investors choose not to submit a bid in the first place. This trend is now likely to become even more pronounced. Parties sometimes attempt to reduce the level of uncertainty by seeking a preliminary understanding with CFIUS. In borderline cases, the parties have sometimes taken the opposite tack and dispensed with CFIUS notification; needless to say, the introduction of mandatory declarations will make this a very high-risk strategy in the future. Another option favored by some sellers is to switch from a trade sale to an IPO, if possible.

### Developments in Berlin

It would be easy to characterize the changes in US investment control as

Trump-style protectionism. In truth, the upcoming changes to US law are by no means a special case, and these kinds of provisions have long been in effect in Germany.



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Foreign investment in particularly security-sensitive sectors, such as certain defense and IT security companies, has long been subject to mandatory notification in Germany. The rules in this realm were tightened in 2017. Since then, investment in operators of “critical infrastructure” or providers of related services has also been subject to obligatory notification. The term “critical infrastructure” is defined more broadly in Germany than the wording initially suggests: it refers not only to energy and telecommunications networks, but also to water supply, certain areas of finance and insurance, health, food supply and logistics. Major gas station operators may be included,

as well as very large pharmacies and food manufacturers. As the rules were tightened, the review periods and waiting times were also extended, in some cases by a significant margin. The three-month period during which the German Ministry for Economic Affairs and Energy (*BMWi*) has the power to initiate reviews of non-notifiable transactions no longer commences upon conclusion of the sale and purchase agreement – now the period begins when the *BMWi* becomes aware of the agreement. If companies fail to proactively obtain a clearance certificate, they will not have transaction certainty until five years after the conclusion of the contract.

A further tightening measure is pending. The current threshold for intervention is acquisition of 25% of the voting rights, but Berlin is likely to soon lower the threshold to 15%.

### Developments in Brussels

There are also moves at the EU level to strengthen investment control. The Parliament, Council and Commission are currently negotiating a draft regulation aimed at achieving this goal. France’s attempt to introduce an EU-wide investment control system was unsuccessful, and decisions on banning invest- →

ments will remain a matter for individual member states.

Nonetheless, EU-wide standardization of factors used in reviews and procedural principles can be expected. Cooperation between the member states and with the Commission is also planned, with reciprocal notification obligations and information rights in ongoing review proceedings. member-states would then be able to comment on proceedings being conducted in other states. In projects of particular importance to the EU, the intention is that the Commission should be able to carry out its own reviews and make recommendations. Even then, with respect to the prohibition of investments, sovereignty will remain with the individual states.

Although the final wording of the regulation remains to be seen, it is already clear that investment control is of growing importance in the EU, and the control policies are going to become more onerous. It is realistic to expect EU-wide agreement on the regulation in the coming months, with the regulation's entry into force following in 2020. ←



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