BONELLIEREDE
BREDIN PRAT
DE BRAUW
HENGELER MUELLER
SLAUGHTER AND MAY
URÍA MENÉNDEZ

THE CHANGING LANDSCAPE OF FOREIGN INVESTMENT REVIEW

Recent years have seen a significant increase in countries equipping themselves with screening regimes in order to deal with the challenges brought about by foreign investment. The scope of investments subject to these regimes has also increased in many countries meaning that more transactions are now subject to mandatory reviews. This briefing considers the factors driving these developments and the practical implications for dealmakers.

Foreign investment under the microscope

Foreign investment is recognised by many governments as an important source of growth, jobs and innovation. Recent years have, however, seen increasing concerns around foreign investment in critical technologies, infrastructure, data and sensitive information. In part, this continues an existing trend exacerbated by trade and geopolitical tensions, but the pandemic has given it a fresh urgency and focus.

Traditional sectors for foreign direct investment (FDI) screening, such as defence, energy and telecoms, have now been joined by new and cutting-edge technologies such as artificial intelligence, data infrastructure, quantum computing and semiconductors. The perceived risk of opportunistic M&A in the wake of the pandemic also saw the healthcare and food supply sectors come under the microscope in some countries.

Evolution of FDI screening in Europe

The growth of FDI screening regimes in Europe provides a neat snapshot of this global phenomenon. In September 2017, the European Commission published a communication proposing to establish an FDI screening framework in the EU. The communication noted that several of the EU's key international partners already had established FDI screening regimes, including Australia, Canada, China, India, Japan and the United States. At that time, less than half of the EU Member States had FDI screening mechanisms in place. Four years later, the Commission issued a new report noting that 24 out of 27 EU Member States had taken measures in this area:

- Adopted a new FDI screening mechanism: Czechia, Denmark, Malta, Slovenia and the Slovak Republic
- Adopted amendments to an existing mechanism: Austria, France, Finland, Germany, Hungary, Italy, Latvia, Lithuania, Poland, Romania and Spain
- Expected to amend existing mechanisms: Netherlands and Portugal
- Expected to adopt a new mechanism: Belgium, Estonia, Greece, Ireland, Luxemburg and Sweden.

In addition to these developments at the national level, the EU FDI Regulation became fully operational in October 2020. The Regulation provides a framework for Member States to notify each other and the European Commission about foreign investments taking place in their territories. The Commission and the other Member States are then given an opportunity to provide their own input on the investment review.

While the EU FDI Regulation provides certain minimal requirements for FDI regimes, it does not introduce a central EU-wide screening mechanism. Clearance, restriction and prohibition of foreign investments remain a matter of national administrative practice and primarily subject to national laws. Nevertheless, the EU FDI Regulation has led to more cooperation between European and national authorities, greater awareness of FDI issues and an increased prospect of national authorities tipping off their counterparts in other countries about transactions that may not have been notified.

Published to provide general information and not as legal advice.

A new dawn for investment screening in the UK

Now outside of the European Union, the UK has also joined the growing list of countries with FDI screening powers. The National Security and Investment (NS&I) regime became fully operational on 4 January 2022 and introduced one of the most wide ranging regimes in the world. The regime permits the UK government to scrutinise and potentially prohibit, unwind or impose conditions on transactions on the basis of national security concerns. The regime is not limited to investment by foreign investors (although the UK government expects that will be its focus), nor is it restricted to investments in UK companies or assets. In contrast to many other foreign investment screening regimes, the NS&I regime catches investments in both UK companies and non-UK companies, provided that the latter carry on activities in the UK or otherwise supply goods or services to people in the UK.

Mandatory notifications are required for qualifying transactions in seventeen sensitive sectors. Voluntary notifications may be made in respect of non-qualifying transactions in those sectors and in respect of certain transactions outside of those sectors. The UK government also has powers to “call in” a non-notified transaction for review where there is a reasonable suspicion that it may give rise to a risk to national security.

Which deals are attracting scrutiny?

Generally speaking, the FDI screening authorities focus on whether a particular deal raises national security or public order concerns due to the identity of the investor or the target business (and the level of control acquired). On the investor side, the involvement of state-owned or funded companies may lead to detailed scrutiny, as may concerns regarding possible illegal or security-related conduct. On the target side, scrutiny may be expected for investments by foreign commercial or state-owned investors in suppliers to the defence and cybersecurity sectors, as well as businesses with other types of critical technologies, supplies, infrastructure, or sensitive information.

Although more deals are now subject to review, most transactions do not require remedies to obtain the necessary FDI clearances. The European Commission’s analysis of the foreign investment reviews reported by the EU Member States in 2020 shows that 80 per cent of notified deals were not formally screened either because of a lack of impact on security or public order, or because they fell outside the scope of the national screening mechanism. Among the cases that were formally screened, 79 per cent were approved unconditionally, 12 per cent required some form of remedy, two per cent were prohibited and 7 per cent were aborted by the parties before an official decision was made. The Commission’s analysis shows that transactions in the manufacturing, ICT and financial services made up the vast bulk of cases that were subject to formal screening.

A similar position is forecast for the UK’s NS&I regime. The UK government expects between 1,000 and 1,830 notifications a year, of which around 70 to 95 (around 5-10%) are expected to be called in for a full assessment and only around ten (around 1%) are expected to require remedies.

Most FDI regimes do not publish detailed decisions given the sensitive nature of the sectors at issue. Nevertheless, the remedies imposed will normally focus on addressing the specific concerns raised by the investor, the target business or the level of control acquired. Contrary to the position in merger control, behavioural remedies tend to be more common than structural remedies to address FDI concerns. This approach permits countries to encourage foreign investment while still empowering them to take steps to address the specific concerns raised by particular investments. For example, behavioural remedies may take the form of restricting access to information, sites or dual-use technology or preventing the transfer of intellectual property. They may also take the form of obligations such as governance provisions, security clearances or retaining existing supply chains or operations within the country.

Published to provide general information and not as legal advice.

In general, outright prohibitions tend to be rare. There have, however, been some notable examples in recent times, including:

- December 2020 – Germany blocked the acquisition of IMST, an engineering company active in satellite, radar and 5G technology, by a Chinese state-owned aerospace company.
- January 2021 – Australia blocked a proposed acquisition of national building contractor, Probuild, by a Chinese state-owned engineering company.
- November 2021 – the Italian government blocked the creation of a semiconductor joint venture between the Chinese company Zhejiang Jingsheng Mechanical, a producer of microchip components, and the Hong Kong branch of Applied Materials, a leading American producer of software for semiconductors.

In January 2021, the French government expressed informally its opposition to the acquisition of the French retail group Carrefour by the Canadian company, Alimentation Couche-Tard, which led to the offer being withdrawn prior to any official decision being taken. In February 2022, following a period in which preliminary national security and competition concerns had been raised by regulators in respect of Nvidia's proposed purchase of ARM, the British semiconductor and software company, it was announced that the parties had abandoned the transaction due to "significant regulatory challenges".

Practical implications

The growth in FDI regimes means that many transactions are now subject to reviews in multiple countries. Investors in potentially relevant businesses should carry out a multijurisdictional analysis of all applicable FDI regimes alongside the usual analysis of merger control and other relevant regulatory approvals.

There can be significant differences in the jurisdictional, procedural and substantive provisions of the applicable FDI regimes meaning that it is important to consider the individual position in each relevant country. For example, it is commonplace for differences to arise in respect of: mandatory versus voluntary filings, qualifying transactions, filing thresholds, sectors covered, standstill provisions, nationality of investors covered, and the structure and timing of proceedings.

Investors need to consider not only their own position but also that of any investment partners. Careful consideration should be given to the structure of transactions, the identity of consortium partners (including whether they are state controlled), their relative proposed stakes, the prevailing political context and the possible measures that may need to be taken in order to address regulatory concerns.

If it is established that FDI filings will be required in some jurisdictions, investors should include suitable conditions, endeavours clauses and timing provisions in transaction documents as would normally be the case for merger control approvals.

In circumstances where a detailed review is likely, the information requirements can be substantial. Typically, the parties will have to provide data on their own activities and third parties such as customers and competitors. Many regimes may "stop the clock" while such information is gathered meaning that investors should seek to prepare as much as practicable of the relevant information in advance.

Where remedies are likely to be required in order to secure FDI clearances, investors should consider the scope for adopting a global approach in order to minimise the risk of conflicting outcomes in different jurisdictions. However, in practice, this can be challenging since the relevant authorities in each country will focus on their own national security or public order concerns, which may differ from those in other jurisdictions.

Published to provide general information and not as legal advice.

What can we expect to see in 2022?

The trend of expanding FDI and national security regimes is likely to continue. As noted above, new regimes and extensions to existing regimes are expected in several European Member States. France, Italy and Spain also announced towards the end of 2021 that the extended FDI controls that were introduced in response to the pandemic would be continued until at least the end of 2022.

It will also be interesting to see how the UK's NS&I regime beds down and whether the anticipated initial flood of notifications will abate once investors and advisors become accustomed to the new regime. The UK government is expected to publish a report in mid-2022 which should provide a window on the first few months of enforcement activity under the new regime.

At the supranational level, the European Commission has launched a study to review the effectiveness of the FDI Regulation that should be completed by summer 2022. The Commission has identified certain weaknesses in the system and so some changes can be expected. The Commission is also planning to issue guidelines for the benefit of both screening authorities and investors, which may be subject to public consultation in 2022.

The Commission has also proposed legislation for dealing with the distortive effects caused by foreign subsidies in the single market. If the legislation is passed, companies in receipt of subsidies from non-EU governments may have to file another notification in Brussels when seeking to acquire EU companies. The Commission would also have powers to impose conditions on or block relevant transactions where the subsidies distort the internal market. The proposed legislation would also grant it powers to investigate other market situations and public procurement exercises affected by foreign subsidies. The European Parliament and the Council of the EU are now discussing the Commission's proposal with a view to adopting a final text of the Regulation.

These expected developments mean that the foreign investment landscape is likely to be a busy and changing area in the months and years ahead.

CONTACTS

Massimo Merola
BonelliErede
+32 2 552 0070
massimo.merola@belex.com

Florence Haas
Bredin Prat
+33 1 44 35 35 35
florencehaas@bredinprat.com

Helen Gornall
De Brauw Blackstone Westbroek
+31 20 577 1455
helen.gornall@debrauw.com

Dr. Jan Bonhage
Hengeler Mueller
+49 30 203 74 173
jan.bonhage@hengeler.com

Lisa Wright
Slaughter and May
+44 20 7090 3548
lisa.wright@slaughterandmay.com

Edurne Navarro
Uría Menéndez
+32 2 639 6464
edurne.navarro@uria.com

Published to provide general information and not as legal advice.