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# Foreign direct investment controls in cross-border acquisitions

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### Introduction

In addition to merger control and other regulatory approvals, an ever-growing number of jurisdictions have now adopted foreign direct investment (FDI) screening mechanisms. These mechanisms aim to determine whether certain investments raise broader national security or other 'public interest' concerns.

For more than 30 years, the Committee on Foreign Investment in the US (CFIUS) has been able to block acquisitions that threaten defence or other critical national interests. In recent years, similar regimes have proliferated across the world.

All G7 countries have operational FDI regimes, with the UK FDI screening mechanism being the most recent addition. With the European Commission (EC) signalling the need for strengthened powers and the entry into force of an EU-level FDI cooperation mechanism in October 2020, 18 out of the 27 EU member states now have FDI regimes that are in force, with another six in the process of adopting FDI legislation (listed under 'FDI Regimes in EU member states' below).

The rapid adoption of FDI regimes across the globe evidences the increasing interest of governments in closely scrutinising a broad range of transactions to determine whether they threaten defence or other critical national interests. This trend has been accelerated by the covid-19 pandemic, the current geopolitical situation in Ukraine and resulting global supply chain issues, all of which have encouraged governments to take steps to protect domestic businesses that are potentially vulnerable to opportunistic foreign investors. Deal teams should consider the need for FDI filings when planning for and developing strategies to mitigate adverse timing and other execution risks. This article will focus on the evolving landscape of FDI controls outside the US.

### FDI regime frameworks

As with merger control review, there is no 'one-size-fits-all' approach when looking at different FDI regimes. Jurisdictions (particularly outside the EU) have taken divergent approaches in seeking to protect their own interests through a variety of mechanisms.

FDI screening regimes – being born out of public interest concerns – tend to confer a great deal of discretion on government authorities, enabling them to cherry pick transactions of interest. One mechanism by which governments achieve this is through the use of broad, nebulous concepts to demarcate the sectoral scope of their regime. Concepts such as 'national defence', 'national security', 'critical infrastructure' and 'critical technology' are frequently utilised by authorities to afford them latitude in taking jurisdiction.

### Sectoral coverage

One of the major variances between FDI regimes lies in their sectoral coverage. Most jurisdictions take a focused approach, identifying (albeit broadly) particularly sensitive sectors within which foreign investments may be subject to review. Crucially, it is not just about national defence. Typically, in addition to defence, this will include categories such as critical infrastructure and critical technology, as well as other sectors politically sensitive to the jurisdiction in question (eg, telecommunications). Certain other jurisdictions (including the Australian, Canadian, German and UK voluntary notification regime) do not limit their review powers according to relevant sectors.

### Transaction structure

Several factors in the transaction structure (including the target's local presence) may impact the obligation to notify. In Japan and India, for example, only direct acquisitions of an interest in a domestic company (with exceptions) are covered. Similarly, a filing can generally be excluded in jurisdictions where the target does not have subsidiaries, branches, offices or assets.

One notable exception to this is the UK, whose current FDI screening regime covers transactions where there is a UK 'nexus'. This could be met by a target with customers in the UK but no other physical presence (eg, a local subsidiary or branch) in the jurisdiction.

Another factor that drives the early FDI risk assessment is the level of control being acquired over the target company. In many jurisdictions, a transaction will not be subject to review if no control is being acquired or if the equity acquired is below a certain threshold (eg, 10 per cent in Spain; 25 per cent (assuming no acquisition of 'material influence') under the mandatory UK FDI regime; and 49 per cent in Mexico). Investors should also be aware that, in the UK, intra-group transfers and restructuring processes may fall within the mandatory notification regime.

Similar to the merger control context, minority investors and acquirers of a majority shareholding should, therefore, consider FDI screening risks before signing. Early consideration of these issues may, depending on the circumstances, allow the parties to adjust the transaction structure to avoid triggering FDI notification obligations.

### Notification obligation

Under most FDI screening regimes, notification is mandatory and suspensory. As such, where a transaction is caught by such a regime,

the parties must notify the relevant authority and may not close the transaction prior to receiving clearance.

Notable exceptions include Canada, which, for most transactions, imposes only a post-closing notification, and the UK, which operates a voluntary notification regime for transactions that fall outside the sensitive sectors that are subject to its mandatory notification regime. Under the voluntary regime, the government reserves the power to 'call in' any transaction that may pose a 'UK national security risk' and, in more sensitive cases, also has the discretion to impose an interim order to block the parties from closing the deal prior to the regulator completing its review. In UK voluntary filing cases, where no interim order is imposed, the parties are able to close the deal, even if the regulator's review is ongoing.

The consequences for failure to comply with an obligation to notify are typically severe. Penalties will often include a fine that, in India and Spain, for example, can be as large as the entire transaction value. In addition, most regimes have the power to require the parties to unwind the transaction pending approval while certain others have the ability to impose criminal sanctions (eg, individuals responsible for a failure to notify may be imprisoned for up to three years in Australia and five years in the UK).

### Investor identity

Some investors' home states may be perceived as more hostile to the host country than others. This tends to affect the outcome of the screening rather than determine which transactions are caught by the initial filing obligation. For instance, in the UK, even a UK-to-UK deal may require notification.

Nevertheless, certain FDI regimes do discriminate on the grounds of particular nationalities. For example, the FDI regimes of certain EU member states (including France, Germany and Spain) contain stricter rules for non-EU/EFTA investors. Similarly, India has expanded its regime to capture all indirect acquisitions of an Indian company by an investor located in a country that shares borders with India (in particular, China).

As such, filings can sometimes be excluded based on the type of acquirer. For instance, in individual EU member states, acquirers from elsewhere in the EEA are regularly exempted from a filing requirement. In contrast, certain acquirers (eg, state-owned or Chinese investors) are more likely to trigger a foreign investment filing or face a higher substantive risk.

### Transaction considerations

#### Timing implications

Given the suspensory nature of a number of FDI regimes, the relevant review period can have particularly acute timing implications for closing deals. For instance, the review process usually takes between four and six months in France, Germany and India. In complex cases, the review period can take as long as nine months to more than one year if remedies are required.

Such long lead times can extend far beyond other closing conditions (including merger control clearance in no-issues cases). It is, therefore, crucial that an FDI risk analysis is conducted ahead of negotiating conditions and termination rights in a transaction agreement.

#### Risk allocation

As described above, FDI screening raises the potential for prohibitively long review periods and the power of the relevant authorities to impose (substantial) remedies or prohibit or unwind transactions altogether where necessary. It is, therefore, crucial that parties consider these risks from the outset and properly consider the allocation of risk in transaction agreements. Parties may increasingly desire deal protections such as a 'hell or high water' clause, obliging the buyer to proceed with the transaction regardless of any obligations imposed in connection with any regulatory approval or reverse termination fees.

#### Information gathering

FDI filings generally require the parties to provide an extensive amount of (sensitive) information to the relevant authorities. In many jurisdictions, such as France, Germany and the UK, the statutory review clock does not start until a complete notification has been received. Furthermore, where requests for additional information are issued, certain jurisdictions, including France, Italy and the UK, have the ability to pause the review clock until the requested information has been provided.

Most jurisdictions operate a clear separation between FDI screening and the merger control review process. Although there will be overlaps in the information required to make concurrent FDI and merger control filings in certain jurisdictions, there will be certain information specific to each and, therefore, an increased information gathering burden.

However, in some jurisdictions (eg, Australia, China and Russia), FDI-related and merger control issues are assessed within the same framework. While there will be FDI-specific lines of questioning, this one-stop shop approach makes for a more streamlined dual-review process.

In the UK, while different regulators are responsible for carrying out the FDI review (the Investment Security Unit (ISU)) and the merger control review (the Competition and Markets Authority (CMA)), statutory information gateways allow for close cooperation between the two. The ISU may disclose information obtained during its FDI review to other public authorities (such as the CMA) and vice versa. In addition, the restriction on UK public authorities from disclosing information obtained in connection with a deal overseas has also been removed. It is therefore expected that the UK government will, in carrying out its FDI review, cooperate with governments in allied countries (eg, CFIUS in the US). Submitting an FDI filing may therefore prompt questions from more than one regulator.

Particularly in light of the timing implications discussed above, expedient information gathering and initiation of the review period can materially advance the transaction closing date.

### Practice points

In practice:

- FDI screening risk should be considered as early as possible in the deal-making process in order to inform both the structure of the investment and the negotiation of transaction documents.
- Given the extensive review period of many FDI regimes, it may be prudent to engage in information gathering ahead of signing to expedite the notification process as far as possible.
- Similar to merger control reviews, substantial fines and unwinding orders (as well as, in some cases, criminal sanctions) may be imposed if the parties fail to notify a transaction, and the outcome of the FDI review may also result in remedies being imposed on the parties as a condition to clearance.

### Recent reforms

#### EU seeks to harmonise European FDI review

On 11 October 2020, Regulation (EU) 2019/452 (the Regulation) creating an EU-wide framework for screening FDI came into force. The Regulation seeks to ensure EU-wide coordination and cooperation on the screening of FDI that is likely to affect security or public order but stops short of the EC's one-stop shop approach to merger control within the EU. Under the EU FDI framework, the EC itself does not have any direct powers to interfere with transactions. Instead, it has two tracks of review powers under which it may issue an opinion.

The first opinion-making power applies where there is proposed FDI into the EU that is (1) likely to affect projects of 'Union interest' and

(2) reviewable on the basis of security and public order. Here, the EC may itself review the proposed investment and issue an opinion. The EC's opinions do not, themselves, carry any legal consequence; however, any member state that reviews the relevant FDI must take 'utmost account' of the EC's opinion and provide an explanation to the EC if its opinion is not followed. Transactions of Union interest are expected to include projects that enjoy substantial EU funding or are covered by EU legislation 'regarding critical infrastructure, critical technologies or critical inputs', such as research (Horizon 2020), space (Galileo), transport (the Trans-European Networks for Transport), energy (TEN-E) and telecommunications.

The EC's secondary opinion-making power applies where an investment does not meet either of the limbs in the preceding paragraph but is subject to FDI screening by a member state. In such circumstances, the member state must inform the EC and other member states 'as soon as possible' following commencement of the review. The EC and other member states may each issue an opinion on the investment, and the reviewing member state must give 'due consideration' to any such opinions received in its review of the particular investment.

Aside from establishing this collaborative approach to FDI reviews, the Regulation also establishes reporting requirements. Each member state, regardless of whether it has implemented an FDI screening regime, must produce an annual report of all FDI that took place in its territory over that time. The EC will then produce an annual report on the implementation of the Regulation, which will be made publicly available.

### FDI regimes in EU member states

While many EU member states (eg, France, Germany and Italy) had operational FDI regimes prior to the Regulation's entry into force, the Regulation has incentivised a number of additional EU member states to introduce FDI regimes.

At present, 18 of the 27 EU Member States (Austria, the Czech Republic, Denmark, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, Malta, the Netherlands, Poland, Portugal, Romania, Slovenia, Slovakia and Spain) have operational FDI regimes. Six other member states (Belgium, Estonia, Greece, Republic of Ireland, Luxembourg and Sweden) are in the process of adopting FDI legislation, some of which will have retroactive effect.

Aside from the rapid increase in EU member states with FDI regimes, we have also observed an increase in the scope of the regimes currently in force.

Spain, a jurisdiction with a historically light-touch FDI regime, has enacted regulations that impose significant regulatory tightening focused on non-EU/EFTA investors and, in particular, those owned or controlled by a foreign government.

Italy has also increased the powers of its government by amending its FDI screening regime to expand the list of strategic sectors to new areas, including the financial, credit and insurance sectors, and has made permanent a number of decrees initially introduced as emergency measures for covid-19.

Germany has similarly expanded the list of sensitive sectors subject to a lower 10 per cent shareholding mandatory filing threshold; personal protective equipment, pharmaceutical essentials and certain medical devices, including IV diagnostic devices, are now included. In addition, new mandatory notification requirements were implemented within Germany's sector-specific FDI review, which now cover all kinds of military equipment (eg, secret patents). There are also new shareholding thresholds for subsequent acquisitions (eg, 20 per cent, 25 per cent, 40 per cent, 50 per cent or 75 per cent for the sectors and groups subject to initial mandatory notification at 10 per cent).

In the Netherlands, the Dutch Senate adopted a bill (expected to enter into force on 1 January 2023) that introduces a general foreign screening regime applying to investments in targets active in vital processes (eg, energy, banking and certain activities at Amsterdam airport and the port of Rotterdam) or sensitive technology (eg, military goods and dual-use items). This new regime will be in addition to the existing regime that applies to the telecommunications sector.

### The UK national security and foreign investment regime

In the UK, a stand-alone foreign investment regime became fully operational on 4 January 2022 under the National Security and Investment Act 2021 (NSIA). This replaced the previous framework, which was tied to UK merger control review. The UK FDI regime is enforced by the ISU of the Department for Business, Energy and Industrial Strategy (BEIS).

The NSIA establishes a dual mandatory and voluntary notification regime. This regime requires mandatory notifications where the target is active in one or more of the 17 broadly defined 'sensitive sectors of the economy' (eg, artificial intelligence, communications, defence and military). However, it also gives the ISU discretion to 'call in' transactions across any sector under the voluntary notification regime where it deems the deal may pose a 'UK national security risk' – a term not defined.

The NSIA is deliberately broadly drafted to give the ISU discretion to assert jurisdiction to review transactions of interest. As the ISU has power to impose serious civil and criminal sanctions for failure to notify (including fines, director disqualification and imprisonment), it is important that deal makers carry out thorough self-assessments and take compliance seriously.

Where a mandatory notification is required, deal timing may be significantly impacted as the NSIA regime is suspensory. However, even where a voluntary notification is submitted, the regime can have a suspensory effect if the ISU issues an interim order preventing parties from closing the deal while its review is ongoing.

Although the statutory review period for most deals is one to three months, reviews may take much longer in complex cases (eg, over six months), especially as information gathering can be onerous and information requests stop the review clock.

### Closing remarks

The recent rapid emergence and expansion of FDI controls in many major jurisdictions should be a focus for dealmakers as they seek to identify and take steps to mitigate adverse deal timing and execution risks. The flurry of protectionist legislative measures taken has jump-started the move towards ever-more prohibitive FDI regimes. While such swift and aggressive adoption of heightened protections is likely to slow, many expect that the momentum will continue in this direction in the coming years.

The ever-growing scope of governments' jurisdiction to review, together with the potential sanctions and remedial action that can be imposed on parties that fail to comply, necessitates engagement with potential FDI issues early in the transaction process. However, prudent attention to this regulatory issue can minimise the negative timing and risk implications now faced in cross-border transactions.

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