POLITICAL INTERVENTION IN GLOBAL M&A: THE DEVELOPMENT OF FOREIGN INVESTMENT REGIMES AND ITS IMPACT ON CROSS-BORDER M&A

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Legal Briefings – By **Joseph Falcone, James Robinson and Veronica Roberts**

This article focuses on the increasing government foreign direct investment intervention in Western economies and compares that to Asian governments' differing approach as they look to encourage FDI in their emerging economies.

Against a background of protectionist rhetoric, public interest and foreign direct investment (FDI) scrutiny in the M&A process is on the increase in traditionally open Western economies. From enhanced review by the Committee on Foreign Investment in the United States (CFIUS), to the expansion of the German FDI regime (with similar proposals at the EU and EU-country level), as well as with longstanding FDI restrictions in many parts of Asia, the current regulatory climate globally presents uncertainties for cross-border M&A.

The historical "level playing field" frustration when it comes to FDI restrictions has turned. Asian countries, and in particular China and India, have progressively opened parts of their economies to FDI and have streamlined their screening processes. At the same time, there is a reverse trend with more restrictive FDI regimes and more active enforcement in the United States, Europe and Australia.

Political interventions in deals in Western economies have traditionally focused on national security, defense and critical infrastructure, as well as regulated industries (though generally on "fit and proper owner" tests, irrespective of nationality). The scope of many Western FDI regimes is now being extended to cover the acquisition of sensitive data, high tech industries and critical technologies by foreign entities.

This article focuses on the increasing government FDI intervention in Western economies and compares that to Asian governments' differing approach as they look to encourage FDI in their emerging economies.

CFIUS

CFIUS is certainly the most interventionist Western regime at present and, following President Trump signing the Foreign Investment Risk Review Modernization Act (FIRRMA) in August 2018, can be expected to continue to be so.

Recent CFIUS impacted deals include: Broadcom's proposed acquisition of Qualcomm (March 2018); Ant Financial's proposed acquisition of MoneyGram (January 2018); and Canyon Bridge Capital's proposed acquisition of Lattice Semiconductor (September 2017—via Presidential order).

While FIRRMA was a less restrictive response than some had anticipated given the protectionist political rhetoric, it will bring a renewed level of scrutiny to foreign investments into the United States (and foreign investments into non-U.S. target companies which have U.S. business operations).

Most notably, FIRRMA expands CFIUS "covered transaction" jurisdiction over control investments to include: (1) real estate purchases near sensitive national security facilities (codifying current CFIUS practice); (2) transactions in connection with bankruptcy; (3) transactions designed to "evade or circumvent" CFIUS review; plus, importantly, (4) non-controlling investments in U.S. businesses holding critical technology and infrastructure or personal data of U.S. citizens, from countries that pose a particular national security concern. In addition, the legislation revamps the CFIUS process, including adding: (1) a permissive declaration route to expedite clearance of transactions with less significant national security concerns; and (2) a mandatory declaration where the acquirer is state-owned and the acquisition would give a non-U.S. government a "substantial interest" in U.S. critical infrastructure or technology, or in U.S. citizens' personal data.

Questions about how CFIUS will implement FIRRMA remain. While certain provisions took effect immediately or will within 18 months, many of the details must await the issuance of new regulations by CFIUS, a process that can take months, if not years, to complete.

That said, FIRRMA has clearly codified into law the recent heightened CFIUS scrutiny of transactions by non-U.S. deal parties, particularly in the technology, telecom and infrastructure sectors.

EU-WIDE REGIME

With pressure from France and Germany to take action in this area, the EU Commission tabled draft legislation in relation to FDI screening on public security grounds in September 2017. Amended and approved by the European Parliament in June 2018, the Commission, Council and the Parliament's Committee on International Trade (the "trilogue") have prioritized reaching an agreement before the May 2019 European elections.

The draft does not propose a power for the Commission itself to screen and block foreign investments—very difficult politically—instead, it proposes: (1) a set of minimum requirements for such controls if EU-countries choose to put them in place, e.g., on grounds of security or public order, and as to transparency, timing and judicial review; and (2) coordination mechanisms between EU-countries and the Commission, including a power for the Commission to review investments in projects of wider EU interest and issue a non-binding, but nonetheless influential, opinion (e.g., if not followed, an explanation of "why not" must be provided to the Commission).

For grounds of security or public order, the draft proposes limiting the review to considerations of the potential effects on: (1) critical infrastructure (including energy, transport, communications, data storage, space and financial infrastructure, as well as sensitive facilities); (2) critical technologies (including AI, robotics, semiconductors, technologies with potential dual-use applications, cybersecurity, space and nuclear technology); (3) security of supply and critical inputs; and (4) access to sensitive information and the ability to control sensitive information.

The inclusion of critical technologies is seen by many as a reaction to mainly Chinese attempts to buy key European IP assets, e.g., Midea's 2016 takeover of KUKA.

It remains to be seen whether, and in what form, the legislation will be adopted, in particular given potential opposition from some EU-countries, such as Greece and Portugal, who see open FDI as vital. However, at the EU-country level, many have already taken steps or issued draft legislation.

GERMAN AMV FOREIGN INVESTMENT RESTRICTIONS

Germany revised its own 2009 FDI regime, the *Außenwirtschaftsverordnung* (AWV), administered by the Federal Ministry for Economic Affairs (BMWi) in July 2017.

Recent AWV impacted deals include: Yantai Taihai's attempted acquisition of aerospace/nuclear component manufacturer Leifeld Metal Spinning (BMWi prohibited in August 2018); State Grid of China's attempted acquisition of a 20 percent stake in transmission-operator 50Hertz (failed after the German government-owned bank KfW invested instead in August 2018).

The AWV allows the German government to block the acquisition of 25 percent or more of the voting rights of a target business if: (1) the investor is located outside the EU/EFTA; and (2) the acquisition is in the military sector or otherwise poses an "actual and sufficiently serious threat to a fundamental interest of society" such that it "endangers public order or security."

Whilst the 2017 reforms do not expand these basic grounds, they: (1) set out a non-exhaustive list of businesses where the government considers an acquisition could pose a particular threat to public order or security; and (2) provide that the signing of a purchase agreement for such businesses must be notified to BMWi.

The list of example businesses is helpful clarification, though it is a lot wider than many would have expected. It covers operators of “critical infrastructures,” developers of software used by such critical infrastructures and providers of cloud computing services. “Critical infrastructures” are defined in detail by reference to particular sectors (and thresholds), including energy, water, food, information technology, telecommunication, health, financial services and transport.

In light of this relatively broad range of businesses, a considerably larger number of acquisitions are expected to be notified.

BMWi has three months from obtaining knowledge of a signed deal to decide whether it wishes to examine a transaction and, if so, has a further four months from obtaining complete acquisition documentation to impose restrictions. If a buyer chooses to notify voluntarily and apply for a clearance certificate (which may, within appropriate limits, be applied before signing), the BMWi has two months to decide whether a closer examination is required, failing which clearance is deemed to be granted. If a buyer fails to notify a transaction and the BMWi does not otherwise obtain knowledge of it, the BMWi can intervene up to five years after deal signing.

While the amendments do evidence an enhanced desire to monitor FDI and its effects on critical business areas, the basic grounds on which the government may intervene have not changed. In particular, the amendments did not introduce any powers to restrict FDI into critical technologies (such as AI, robotics, semiconductors or cybersecurity, except where expressly listed as a military application) or for reasons of industrial policies or lack of reciprocity.

A MORE INTERVENTIONIST UK?

The UK has traditionally been one of the most open of the European economies to foreign investment. Indeed, the UK government currently has national security powers to intervene only in those transactions that meet the jurisdictional thresholds of the UK (or EU) antitrust merger control regime (subject to limited exceptions).

Following public disquiet over the investment by China General Nuclear Power in the new Hinkley Point nuclear project, in October 2017 the UK government published a consultation paper proposing to extend its powers of national security review.

In June 2018, the UK government reduced the jurisdictional thresholds for certain transactions in specified sectors: military, quantum technology and computer hardware (with one governmental intervention under these rules to date – the acquisition by Chinese-controlled Gardner Aerospace of Northern Aerospace, cleared in July 2018).

Then, in July 2018, the UK government published a White Paper setting out its proposals for a more significant overhaul, enabling the government to review transactions for national security risks on an economy-wide basis, with sectors most likely to give rise to national security concerns to include national infrastructure, advanced technologies, direct suppliers to government/emergency services and dual-use technologies.

The proposed national security review will be a distinct regime with no turnover/market share requirements, so with the potential to capture smaller transactions. The triggers would be share acquisitions of 25 percent or more, or the acquisition of significant influence over an entity or asset. It would be a voluntary notification system, with the right to intervene where parties choose not to notify, and a six month call-in period post-completion.

The UK government has stressed that the UK remains open for investment (particularly important post-Brexit) and emphasizes in the White Paper the narrow national security grounds for review. However, Prime Minister May has previously declared the need for a “proper industrial strategy” to protect strategic interests (citing Pfizer’s attempted 2014 acquisition of AstraZeneca). The UK government expects to introduce a new regime from around May 2019.

ASIA-PACIFIC

Whilst Western states demonstrate an increased tendency to enact protectionist FDI-related policy, the reverse has been true in the Asia-Pacific region. In 2016, the Asia-Pacific saw the adoption of 52 FDI-related policies, 43 of which were facilitative of foreign investment. Between January 2017 and June 2018, 47 of the 74 FDI-related policies adopted in the region were characterized by the UN Economic and Social Commission as “liberalising” (with the remainder falling into the bracket of either “neutral” or “restrictive”).

During this latter period, it was China, India and Vietnam that were most active in this field with their policy-making activities weighted heavily towards measures that would liberalize their respective FDI regimes. Such efforts are reflected in the numbers, with 2018 seeing China attract a record $136 billion in investment, making it the second highest recipient of foreign capital worldwide.

This trend does not, however, hold true for every state in the Asia-Pacific region. In recent times, the region’s fourth most active policy-maker in this sphere has been Australia. However, despite being well-known for its strong and well-established FDI regime, over 70 percent of its recent policy amendments have either been regulatory or restrictive of FDI.

Australia has displayed a particularly protectionist approach to FDI from China. There has been recent political debate as to whether Australia’s Foreign Investment Review Board should allow a A$13 billion bid from a Chinese entity to buy APA Group and this tendency is likely to continue following the recent appointment of Scott Morrison as Prime Minister. During his time as federal Treasurer, Mr. Morrison gained somewhat of a reputation for blocking Chinese investments. Examples include blocked bids for electricity distributor, Ausgrid and for Australia’s largest private landowner, S. Kidman and Co. Limited.

CONCLUSION

In summary, the key impacts of foreign investment regimes on cross-border M&A are: (1) possible FDI approvals will need to be considered early, i.e., alongside antitrust merger filings; (2) FDI regimes are more unpredictable than antitrust reviews, with broader discretionary governmental powers and less transparency of decision-precedents, so early engagement with the relevant authorities is likely to be advisable; (3) given many regimes are suspensory, timing of deals may be significantly impacted; and (4) competing bid or, where hostile, defensive scenarios will be more complex.

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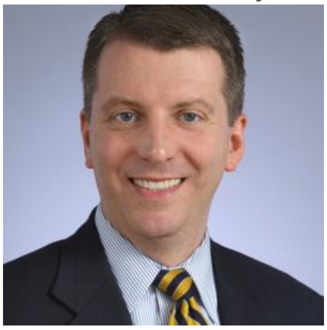
KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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