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Introduction: Key Current Trends – Global Overview

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Introduction

Foreign direct investment (FDI) regulation has become an increasingly critical piece of the regulatory jigsaw in recent years. FDI flows have started to surge back to above pre-pandemic levels,[2] but we are also seeing a continuing trend towards greater protectionism and stricter enforcement, initially resulting from the unprecedented economic fallout of the covid-19 pandemic, followed swiftly by heightened geopolitical tensions. This means it is more important than ever before to consider the potential application of FDI rules to cross-border M&A from the outset. Many existing FDI screening regimes have been expanded in recent years and – particularly in the EU – a significant number of new regimes have been adopted.[3] It is critical that deal parties and their advisers identify as early as possible in the transaction planning process what investment screening issues may arise, how these might be addressed, and whether they may ultimately threaten the viability of the transaction.

The shift towards stricter scrutiny, both in terms of policy frameworks for screening inward foreign investment and the way in which they are applied, is well illustrated by a number of recent high-profile deals that have been blocked or unwound by FDI regulators (or abandoned following indications that clearance would not be obtained), including *Kunlun/Grindr* (US, 2019), *Teledyne/Photonis* (France, 2020), *Mengniu Dairy/Lion Dairy and Drinks* (Australia, 2020), *China State Construction Engineering Corporation/Probuild* (Australia, 2021) and *Super Orange HK Holding Limited/Pulsic* (UK, 2022). Even where FDI clearance is ultimately obtained, extensive commitments may be required to address national security concerns, and dealmakers should not underestimate the potential impact of the review and approval process.

Understanding the global trends at play, as well as staying on top of frequent and fast-moving changes in the FDI rules applicable in individual jurisdictions, is critical to navigating this increasingly fluid and uncertain environment for foreign investment. In this introductory chapter, we set out an overview of the key global trends, which are then explored in more detail in subsequent chapters of this guide. We highlight some notable examples of these trends in action in particular jurisdictions and offer practical guidance for investors seeking to minimise deal risk. In doing so, we emphasise the importance of recognising that the overall picture is one of significant structural change: although some amendments to individual FDI regimes directly related to the covid-19 pandemic or specific geopolitical tensions may ultimately prove to be temporary, the majority of recent amendments are permanent, and enhanced FDI scrutiny of transactions seems likely to continue longer term.

The evolving concept of ‘national security’

‘National security’ is well established as the pre-eminent public interest justification for state intervention in foreign investment. However, as explored further below and in more detail in Chapter 1, the scope of sectors and technologies considered by policymakers to fall within this concept in the context of FDI regulation has evolved in recent years to become much broader than simply military and defence interests. In many jurisdictions, FDI regulations now apply to transactions relating to critical infrastructure (including energy networks and ports), communications assets and advanced technology and data. A number of regimes potentially extend still further to acquisitions in other sectors that are considered key to critical supply chains or to keeping public life running smoothly, from airports to hospitals to food safety. Against the backdrop of the covid-19 pandemic, there has also been a particular focus recently on foreign investment in the healthcare sector, with increased scrutiny of transactions involving businesses deemed critical to the national public health response. This means that transactions in a very wide range of sectors may potentially be at risk of review, including those that perhaps at first sight do not immediately appear likely to give rise to concerns. Indeed, under the Japanese FDI regime, even ‘leatherworking’ has been identified as a ‘strategic sector’ for the purposes of FDI regulation.

This trend can be seen in practice in a number of recent government interventions under FDI rules. For example, the Committee on Foreign Investment in the United States (CFIUS) has intervened in transactions involving digital maps for the automotive industry (*Navinfo/HERE Technologies* (2017)) and digital apps (*Beijing Kunlun Tech Co Ltd/Grindr LLC* (2019)) and *Beijing ByteDance Tech Co Ltd/Tik Tok* (2020)), in light of concerns about foreign access to and storage of personal information. New powers to intervene in transactions on national security grounds in Australia were used in January 2021 to effectively prohibit a takeover of building contractor Probuild, in light of concerns that the proposed acquisition by state-owned China State Construction Engineering Company could give Chinese intelligence services access to information about Australian critical

infrastructure.[4] In France, government ministers made it clear at a very early stage that they opposed the proposed acquisition of the French supermarket chain Carrefour by the Canadian company Couche-Tard on the ground of 'food security' and the deal was abandoned.

The broadening of the concept of 'national security' can make it increasingly difficult for investors to assess confidently the risk of intervention under FDI rules, especially given that – unsurprisingly – governments and FDI regulators tend not to clearly delineate or expressly define the concept in legislation or written guidance (beyond identifying a non-exhaustive list of potentially sensitive sectors where national security concerns may arise). However, it is notable in this regard that US President Biden issued an Executive Order on 15 September 2022 that provides formal direction – for the first time since CFIUS was established in 1975 – on priority national security factors to be considered when evaluating a transaction. The factors specified in the Executive Order are: (1) the effect of the transaction on the resilience of critical US supply chains that may have national security implications, including those outside of the defence industrial base; (2) the effect of the transaction on US technological leadership in areas affecting national security, specifying an extensive (and non-exhaustive) list including microelectronics, AI, biomanufacturing, quantum computing, advanced clean energy, climate adaptation technologies and elements of the agricultural industrial base that have implications for food security; (3) industry investment trends that may impact national security, such as multiple acquisitions in the same sector; (4) cybersecurity risks that threaten to impair national security; and (5) risks to US persons' sensitive data, noting that data is an increasingly powerful tool for the surveillance, tracing, tracking and targeting of individuals or groups of individuals. It is generally understood that these factors were already being taken into account by CFIUS, but the issue of a formal order provides a helpful framework for investors to apply when assessing the likelihood that a transaction will attract particular scrutiny – both specifically under CFIUS regulations and also more generally in other major jurisdictions where FDI regulators are likely to take a similar approach.

In practice, it is arguable that the concept of 'national security' as the basis for intervention pursuant to FDI regulation is becoming more akin to a broader notion of 'national interest'. However, only a handful of developed countries – most notably Australia, France and Canada – have formally opted for a wider 'public interest' test for government intervention in foreign investment; in the majority of jurisdictions the focus remains on 'national security', albeit broadly interpreted and not usually clearly delineated or expressly defined in legislation. Indeed, significant reforms that took effect in Australia from 1 January 2021 have resulted in an express renewed focus on sensitive 'national security-related' businesses under the Australian FDI regime. Similarly, in the context of the passage of the UK National Security and Investment Act 2021 through the parliamentary approval process, the UK government expressly rejected calls for the new regime (which came into force on 4 January 2022) to be used to justify intervention in transactions on broader 'national interest' grounds concerning industrial policy or protection of jobs in the United Kingdom.

A further related trend is an increased political focus on the impact of consolidation of international value chains where this is perceived to work against the interests of countries that have nurtured the targeted industries (in particular in advanced manufacturing, research-intensive and technology sectors). However, the real concern here is often not the implications for 'national security' (even broadly defined), but rather the intentions of acquirers with rationalisation and relocation of value-adding activities in mind. In such cases, it may be possible to put forward remedies to address these concerns outside the formal FDI (or public interest merger control) regime. This may take the form of voluntary undertakings or non-binding pledges on issues such as maintaining domestic investment or employment (as illustrated by *Canyon Bridge/Imagination* (2017, UK)),[5] or careful structuring of the transaction in a way that alleviates concerns combined with proactive engagement with the objective of securing political support (as illustrated by *Piraeus Port/Cosco* (2016, Greece)[6] and *Fincantieri/STX* (2017, Italy)).[7] Where more formal commitments are required, but no real national security concerns arise, it may still be possible to agree these without a formal FDI or public interest intervention, as illustrated by the approach taken to the acquisition of UK mobile technology company Arm by Japanese firm Softbank in 2018, in which the UK government sought and received formal post-offer undertakings to keep Arm's headquarters in the UK and to double the UK workforce. However, acquirers should be careful that, in agreeing these types of remedies, they believe that they will be able to comply with them in practice, potentially over a significant time frame: in January 2021, Volkswagen was formally warned by the French Minister of the Economy (referencing both potential civil and criminal liability) to respect its existing commitments with regard to its French subsidiary, MAN Energy Solutions (a strategic supplier to the French Navy specialising in emergency engines for submarines) in light of the fact that Volkswagen was considering significant redundancies at MAN following unsuccessful sale attempts.

A widening focus beyond China

Historically, there has been a particular focus in decisions from a number of jurisdictions on the perceived risks of Chinese investment (or investment viewed as influenced by China) to national security. For example:

- In the United States, all four deals blocked by CFIUS under the Trump administration in the US involved Chinese acquirers or concerns relating to China: the acquisition of money transfer company Moneygram by Ant Financial Services Group (part of Chinese conglomerate Alibaba) (January 2018); the acquisition of Qualcomm by Broadcom (March 2018);[8] the acquisition of dating app Grindr by Chinese conglomerate Beijing Kunlun Tech Co. (May 2019); and the acquisition of the Musical.ly video app (later merged into TikTok) by Beijing ByteDance Tech Co (August 2020).[9] Chinese investment in US businesses appears to remain a key concern for the Biden administration: the Executive Order issued by President Biden on 15 September 2022, discussed in the previous section of this chapter, is not targeted towards any particular country, but explicitly recognises that

'some countries use foreign investment to obtain access to sensitive data and technologies for purposes that are detrimental to US national security.'

- In Germany, both deals blocked to date have involved Chinese investors: the acquisition of Leifeld Metal Spinning AG by Yantai Taihai Corporation in August 2018 (ultimately abandoned prior to a formal prohibition decision), and the acquisition of IMST (a specialist in mobile communications, radar and satellite technology) by a subsidiary of the Chinese company Casic in December 2020. Prior to these prohibition decisions, the German authorities had also withdrawn their initial approval of the acquisition of Aixtron by the Fujian Grand Chip Investment Fund in late 2016, at US urging (although it was the US authorities that ultimately blocked the deal, a second review by the German authorities may have led to the same conclusion). In August 2018, political influence was also used to prevent State Grid Corporation of China from acquiring a 20 per cent minority stake in 50Hertz, one of Germany's four providers of high-voltage transmission systems.
- In the United Kingdom, the government has intervened in a number of transactions involving Chinese investors in recent years, both under the public interest merger control regime used to intervene in mergers on national security grounds prior to 4 January 2022, and more recently under the new investment screening regime set out in the National Security and Investment Act 2021. For example, in 2019 the government intervened in the proposed acquisition of Impcross Limited (a UK manufacturer of parts for military aircraft) by Gardner Aerospace Holdings Limited (ultimately controlled by a Chinese-listed entity) and the proposed acquisition of Mettis Aerospace by Aerostar (a fund based in China). Both these transactions were ultimately abandoned. The same fate befell the acquisition of Perpetuus Group (a UK advanced materials specialist) by Taurus International Ltd and Dr Zhongfu Zhou (a Chinese academic) in May 2022. Since the entry into force of the National Security and Investment Act 2021 on 4 January 2022, transactions that have been called in for review on national security grounds have included the acquisition of Pulsic (a UK electronic design company) by Hong Kong company Super Orange HK (ultimately blocked in August 2022) and the acquisition of Newport Wafer Fab (a UK micro-chip factory) by Chinese-owned Nexperia NV (decision pending at the time of writing (September 2022)).
- In Australia, much of the recent focus has been on acquisitions by both Chinese and Hong-Kong based companies, due in large part to concerns about China's influence over Hong Kong. Recent examples include the proposed takeover of APA Group by Cheung Kong Infrastructure (blocked in November 2018), and the proposed acquisition of building contractor Probuild by the state-owned China State Construction Engineering Corporation (withdrawn in January 2021 after indications that the Australian authorities would not approve the transaction).

However, it is clear that the focus of government intervention in relation to foreign investment is now increasingly also widening beyond China: over 85 per cent of acquisitions reviewed by CFIUS in both 2020 and 2021 involved non-Chinese purchasers,[10] as did the first publicly announced refusal of FDI authorisation in France, the proposed acquisition of the French company Photonis (which develops applications with military uses) by the US group Teledyne in 2020.[11] Similarly, a majority of the interventions on national security grounds in the United Kingdom in 2019–2021 under the public interest merger control regime involved non-Chinese acquirers. These included proposed acquisitions involving investors from Canada (*Connect BidCo/Inmarsat* (2019)) and the United States (*Advent International/Cobham* (2019), *Parker Hannifin Corporation/Meggit plc* (2022), *Cobham Ultra Acquisitions Limited/ Ultra Electronics Holdings Plc* (2022) and *NVIDIA/Arm* (2022). Based on the limited publicly available information regarding the transactions that have been called in for review by the UK government under the new National Security and Investment Act 2021, this trend is continuing under the new stand-alone screening regime in force since 4 January 2022: transactions under review have involved investors from France (*Altice/BT*), the United Arab Emirates (*Tawazun/Reaction Engines*) and even the United Kingdom (*Epiri*s/Sepura).

Intra-EU investments are also attracting additional scrutiny under FDI rules. However, it is notable that the European Commission recently made clear that it will assert its exclusive jurisdiction to review transactions that fall within the scope of the EU Merger Regulation, and challenge the use by EU Member States of national FDI regimes to block any such transaction, if it does not consider that the prohibition is genuinely aimed at protecting a legitimate interest of the relevant EU Member State.[12] In the context of the acquisition of Dutch insurer Aegon's Hungarian subsidiaries by Austrian insurer VIG, the Hungarian government initially blocked the transaction under FDI rules, but was forced by the European Commission to withdraw the veto decision in February 2022. In this particular case the European Commission considered that it was unclear how VIG's acquisition of Aegon's Hungarian assets posed a 'fundamental threat to society', given that the two companies were both established European insurance companies with an existing presence in Hungary.

In the majority of these examples of government intervention in transactions involving non-Chinese investors, it has ultimately proved possible to deal with the concerns by agreeing undertakings relating to matters such as the maintenance of strategic capabilities and the protection of sensitive information. However, this will not always be the case – as illustrated by *Teledyne/Photonis* (France, abandoned in December 2020) and *NVIDIA/Arm* (UK, abandoned in February 2022) – and dealmakers should not underestimate the potential impact of the review and approval process.

Increase in global protectionism accelerated by the covid-19 pandemic and geopolitical tensions

The trend towards increased global protectionism has undoubtedly been accelerated by the unprecedented economic fallout of the covid-19 pandemic, which resulted in many governments seeking to protect companies – particularly those critical to the domestic response – from opportunistic acquisitions by foreign buyers. EU-level guidelines on FDI screening published by the European Commission on 25 March 2020[13] specifically identified healthcare – including production of medical or protective equipment and medical research – as a sector considered to be particularly vulnerable to increased exposure to FDI (and deserving of protection) in light of the pandemic. As explored further below, this was reflected in specific amendments made to the FDI regimes of a number of EU countries during the early stages of the pandemic, including Spain,[14] Italy[15] and Germany.[16] Increased scrutiny of foreign investment in response to the pandemic also emerged outside Europe, as illustrated by changes to the regimes in Japan, Australia, Canada and – in a marked contrast to its previous direction of travel towards relaxation of FDI rules – India, also discussed further below.

Heightened geopolitical tensions have also been an important contributory factor. In addition to the ongoing tensions surrounding China and foreign investment connected to the Chinese government already explored above, the recent Russian military aggression against Ukraine has resulted in increased scrutiny of investment with a direct or indirect connection to Russia or Belarus (as an active supporter of Russia). The European Commission has been notably proactive in this regard, issuing guidance[17] to Member States on 6 April 2022 expressly calling for increased vigilance against Russian and Belarusian FDI into the EU, in light of concerns that the Russian and Belarusian governments may have strong incentives to interfere with investments related to critical activities in the EU and pose an increased threat to security and public order. The guidance encourages Member States to systematically check such FDI and scrutinise it carefully, and to ensure close cooperation between national authorities responsible for sanctions enforcement and national authorities responsible for screening of FDI. Foreign investment into Russia has similarly been subject to greater scrutiny since the launch of the Russian attack in Ukraine: on 7 March 2022 the Russian government published a lengthy list of foreign states and territories that are deemed to have committed ‘unfriendly’ actions against Russia, which includes the United States, Canada, the United Kingdom, all EU Member States and Australia, among others. Any acquisitions of Russian companies involving acquirers from these ‘unfriendly’ countries must now be approved by the Russian Commission for Control over Foreign Investments.

Impact on FDI regulation: overview

The global trends explored above have cumulatively resulted in significantly enhanced scrutiny of FDI in many jurisdictions in recent years. This has manifested itself in a number of different ways: the overview set out below highlights some recent examples, with further detail set out in subsequent chapters.

Expansion of the sectors in which FDI regulation applies

As discussed above, the scope of many FDI regimes now extends well beyond military and defence matters and also encompasses transactions relating to critical infrastructure, communications assets and advanced technology and data, among other sectors. Although the expansion to acquisitions in the healthcare sector in a number of jurisdictions was largely a response to the covid-19 pandemic, much of the recent expansion of the sectors to which FDI regulation applies has been implemented on a permanent basis, independent of considerations relating to the pandemic response. For example:

- The list of ‘sensitive sectors’ to which FDI regulation applies in France was expanded with effect from 1 January 2019 to include space operations and research and development (R&D) activities linked to sensitive technologies and activities (cybersecurity, artificial intelligence, additive manufacturing and semi-conductors). Subsequent amendments have added production, transformation and distribution of certain agricultural products (in cases where certain food safety objectives apply to the products in question), publishing, printing and distribution of media including online media services and R&D activities linked to quantum technologies, energy storage and biotechnology.
- In Germany, significant reforms to the German FDI regime announced in May 2021 include new filing obligations focused on acquisitions of high-tech enterprises, including companies developing automated or autonomous driving functions, specific nano-electronic components and certain smart meter gateways.
- Spain significantly tightened its FDI regime on a permanent basis with effect from 17 March 2020, requiring acquirers who are not within the European Union or the European Free Trade Association (EFTA) to obtain prior approval for an acquisition of a shareholding of 10 per cent or more, or a management right, in a Spanish company in a very broad range of sectors, including critical infrastructure and technology, healthcare, communications, energy and transport, media, the supply of key inputs such as energy, raw materials and food security, as well as any other sector with access to sensitive information (in particular personal data).
- In the United Kingdom, the new mandatory notification regime introduced by the National Security and Investment Act 2021 (in force since 4 January 2022) extends to qualifying acquisitions of control of target entities that carry out specified activities in the United Kingdom in one or more of 17 specified sectors. These include energy, transport, communications, artificial intelligence, data infrastructure and a number of other tech-related sectors.[18]
- In Canada, a policy statement published on 18 April 2020 (in the context of the covid-19 pandemic) explained that, until Canada was considered to have recovered from the pandemic, the Canadian government would scrutinise with particular attention FDI of any value, controlling or non-controlling, in Canadian businesses that are related to public health or involved in

the supply of critical goods and services to Canadians or to the government. Subsequent Canadian guidelines issued on 24 March 2021 also added acquisitions of Canadian businesses that have access to sensitive personal data, use sensitive technology or are involved in producing critical minerals to the areas that could raise national security concerns for the purposes of the Canadian FDI regime.

- In Japan, regulations implemented in June 2020 designated the manufacture of pharmaceuticals for infectious diseases and the manufacture of certain medical devices (such as heart–lung machines and ventilators) as both 'designated businesses' and 'core businesses' under the Foreign Exchange and Foreign Trade Act. This means that acquisitions of almost any shareholding in a Japanese company active in these markets (1 per cent or more in a listed Japanese company, or any shareholding in a non-listed Japanese company active in these markets) must be notified to the Japanese government prior to completion (subject to certain exemption conditions), and then subject to a 30-day waiting period during which the government may review and raise objections to the planned investment. Classification as a 'core businesses' means that most of the exemptions that may apply to other 'designated businesses' will not apply. This was stated to be intended to maintain domestic production capabilities in light of the covid-19 pandemic, but has been maintained at the time of writing (September 2022).

Differentiation based on the identity of the investor

Many jurisdictions are increasingly subjecting FDI to different levels of scrutiny depending on the identity of the investor, as a means of balancing the economic importance (and often necessity) of inward FDI from 'friendly' countries against a desire to ensure enhanced scrutiny of potentially hostile foreign investment.

This sort of targeted approach has been a feature of a number of regimes for some time. For example, in Canada, the applicable financial thresholds differ depending on whether the investor originates from a country with which Canada has a trade agreement or that is part of the World Trade Organization. The financial thresholds also differ depending on whether the foreign investor is a state-owned or non-state-owned entity. In the United States, there is a legal presumption that any relevant investment by a state-owned acquirer should be subject to a second, more detailed 45-day review by CFIUS, subject to certain exceptions. However, this approach is now being extended further as a means of adopting a stricter approach to certain types of investors, against the backdrop of heightened geopolitical tensions highlighted above.

Within the European Union, there is a general trend towards stricter scrutiny of non-EU/EFTA investors and foreign investors directly or indirectly controlled by foreign governments. This trend is illustrated by the recent reforms in Spain discussed above, as well as the lowering of notification thresholds for investments by non-EU investors in France (see below) and an amendment to the intervention threshold in Germany for non-EU investments so as to require only that the foreign investment is 'likely to affect' public security or public order, rather than requiring an 'actual threat' to public safety or order.[19] As discussed above, more recently there has also been a particular focus on foreign investment in the EU with a direct or indirect connection to Russia or Belarus.

The Canadian government has also made clear that enhanced scrutiny will now apply to all foreign investments by state-owned enterprises or private investors assessed as being closely tied to or subject to direction from foreign governments. In India, restrictions introduced in April 2020 require any foreign investment by a non-resident based in a country that shares a land border with India to be approved in advance by the government (irrespective of the sector into which the investment is made, as an exception to the usual sector-by-sector process).[20]

A similar approach, albeit implemented in a slightly different way, can also be seen in the United States, where reforms expanding the jurisdiction of CFIUS with effect from 13 February 2020 included identifying 'excepted investors' with substantial ties to friendly countries (currently designated as Australia, Canada, New Zealand[21] and the United Kingdom), which are exempt from filing requirements that would otherwise apply to certain non-controlling 'covered' investments in US businesses (rather than identifying countries from which inward investment will be subject to stricter scrutiny).

It is notable, however, that the new national security screening regime in force in the United Kingdom since 4 January 2022 does not make any formal distinction between different types of investors and, indeed, applies in principle to both non-UK and UK investors alike. The government has acknowledged that UK investors will be inherently less likely to give rise to national security concerns in practice,[22] but there is already at least one example of an acquisition by a UK acquirer being called in under the new regime – *Epiris/Sepura* – which was only permitted to proceed subject to commitments.[23] Similarly, the EU FDI Regulation[24] is 'nationality neutral', insofar as it applies equally to all FDI in EU Member States by non-EU investors (although the review framework set out therein does not apply to EU investors, and so does involve an important degree of differentiation in that regard).

Increased use of mandatory notification requirements

Mandatory notification for certain transactions (combined with a corresponding prohibition on completion prior to clearance) has long been a feature of FDI regimes in some jurisdictions, such as France and Japan. However, a number of FDI regimes that have been based historically on a largely voluntary notification system (combined with powers for the relevant authority to 'call

in' for review transactions that trigger the relevant thresholds) have recently moved towards a (wider) mandatory notification system.

This is well illustrated by recent reforms in Germany, where a major revision of the FDI regime initiated in March 2020 has significantly expanded the scope of mandatory filing requirements to a much wider range of business activities (with further expansion of the sectors covered announced in May 2021 – see above). Mandatory notification for certain transactions in specified sectors is also a key feature of new investment screening regimes recently introduced in the UK and the Netherlands, both of which also have retroactive effect (that is to say they will apply to certain notifiable transactions completed prior to the commencement date of the relevant legislation).[25] This trend also extends beyond Europe: for example, in a departure from previous CFIUS practice, the implementing regulations of the Foreign Investment Risk Review Modernization Act of 2018 that took effect on 13 February 2020 impose mandatory filing requirements for certain 'covered investments' in US businesses that deal in critical technology, critical infrastructure or sensitive personal data.

Lowering of notification thresholds

Stricter scrutiny of foreign investment has also been achieved in a number of jurisdictions by lowering the shareholding or turnover thresholds that trigger a notification requirement (often in conjunction with one or more of the other means of tightening restrictions discussed above).

For example, the threshold for notification of investment by non-EU investors in a French company active in a sensitive sector was lowered from 33.3 per cent to 25 per cent of share capital or voting rights from 1 April 2020. This threshold was subsequently temporarily lowered further in July 2020, to 10 per cent, for acquisitions by non-EU investors of shareholdings in strategic French listed companies: this amendment was originally due to expire at the end of 2020, but was subsequently extended to 31 December 2021 and again more recently to at least 31 December 2022. In Japan, the threshold for notification and pre-transaction approval was lowered with effect from 7 June 2020 from 10 per cent to just 1 per cent for foreign investment in Japanese listed companies active in a wide range of regulated sectors deemed relevant to national security.

In Australia, a similar approach was adopted in relation to financial, rather than shareholding, thresholds: with effect from 29 March 2020, the financial threshold for review in terms of a target's valuation was temporarily lowered to A$0 (largely as a response to the pandemic). This was a particularly significant change for investors from countries that have free trade agreements with Australia (such as the United States), which otherwise benefited from a threshold of approximately A$1.2 billion for investment in certain (non-sensitive) sectors. This temporary A$0 threshold has since been removed with effect from 1 January 2021 (and monetary thresholds restored to pre-pandemic levels), but it is notable that a A$0 threshold still applies to notifiable national security transactions under the new regime introduced in January 2021 (see above).

Increased powers to impose sanctions for non-compliance

Enhanced scrutiny of foreign investment has been accompanied by increased powers to impose sanctions for non-compliance in many jurisdictions, and an increasing willingness to use them. Such sanctions can include both significant monetary fines (which may be up to the value of the transaction, as seen in the United States, or calculated as a percentage of worldwide turnover, as seen in the United Kingdom), and criminal sanctions for individuals including imprisonment (as seen in Germany, the United Kingdom and Australia).[26]

In addition, in jurisdictions where a 'standstill' obligation applies preventing completion prior to clearance, breach of this obligation may result in the transaction being deemed void – either as a result of a decision by the relevant authority (as is the case in, for example, the United States and Australia), or automatically (as is now the case in the UK for certain transactions, unless retroactive validation can be obtained successfully).

Liberalisation of FDI regimes derailed in Asia?

Prior to the covid-19 pandemic, a notably contrasting approach had begun to emerge in a number of Asian countries, where policymaking activities were heavily weighted towards measures intended to liberalise FDI regulation, including opening up more sectors to foreign investment and streamlining the process for approval. This approach was illustrated well by the Foreign Investment Law that came into effect in China on 1 January 2020, implementing a significant overhaul of the previous regime. Similar strategies were pursued in India and Vietnam, and record levels of inward investment followed.

However, it appears that this trend has been somewhat derailed by the impact of the pandemic combined with increasing global geopolitical tensions. More recently, we have seen the opening up to foreign investment slowing down in countries such as China, as well as a shift back towards additional restrictions in certain other Asian countries. For example, as already discussed above, FDI regulations were tightened in India in April 2020 to require prior approval for any foreign investment by a non-resident based in a country that shares a land border with India, irrespective of the sector into which the investment is being made. Since 7 March 2022, any acquisitions of Russian companies involving acquirers from a lengthy list of 'unfriendly' countries must now be approved by the Russian Commission for Control over Foreign Investments.

Practical guidance for investors

As already emphasised in the introduction to this chapter, enhanced scrutiny and stricter enforcement mean that it is now more important than ever before that deal parties and their advisers consider early in the transaction planning process what investment screening issues may arise, how these might be addressed, and whether they may ultimately threaten the viability of the transaction. It is important to bear in mind that investment screening regulations may be applicable even where the investor may not, at first sight, appear to be a 'problematic' or indeed even 'foreign' investor: for example, recent guidelines published by the French Ministry of Economy make clear that French citizens who are tax resident in another country will be considered 'foreign' for the purpose of French FDI regulations, as will entities incorporated in France where they are controlled by an individual who is a foreign national or a French national but tax resident in another country. As discussed above, UK acquirers now have to make mandatory filings in the same way as non-UK acquirers when the transaction falls within the scope of the relevant provisions of the National Security and Investment Act 2021. The potential relevance of investment screening rules should therefore be carefully considered in all cases.

The first step should always be to carefully consider the potential for criticism of the transaction on national security and national interest grounds at the outset. In some cases, the political sensitivity of an acquisition may well be obvious: for example, transactions involving military or dual-use products. However, it is also important to think beyond the established legal parameters for blocking foreign investment in considering why an acquisition might be politically contested. State backing (whether direct or indirect), or the acquisition of critical infrastructure, technologies or sensitive data will always be 'red flags', even if carefully managed. Extensive rationalisation or consolidation plans, which may incentivise a deal for investors on paper, can also look like corporate social irresponsibility to political stakeholders. In the current mood, anticipating this kind of objection is essential, followed by proactive and sensitive engagement with the process of securing political support. The assessment will involve taking into account previous interventions, current regulatory trends and the political context.

From a practical perspective, the potential application of filing and approval requirements, and the related allocation of risk associated therewith, will require careful consideration. It is important to bear in mind that if a transaction is completed without prior approval, and subsequently investigated under FDI rules, the relevant authorities may go so far as to require the deal to be entirely unwound. In some jurisdictions this can remain a risk for a considerable period of time, as illustrated by the first ever unwinding order issued by the Italian FDI authorities in March 2022, which (according to press reports) related to a transaction completed in 2018 involving the acquisition of a majority stake in an Italian drone manufacturer by a Hong-Kong based acquirer ultimately owned by the Chinese government.[27]

Where one or more FDI notifications needs to be made, it will be important to factor in that, in addition to the expense associated with the preparation of the notification itself, filing fees in respect of FDI notifications are becoming increasingly common and can be significant. For example, in the United States, filing fees of up to US$300,000 were introduced with effect from 1 May 2020 for CFIUS notices filed in connection with both control transactions and certain non-controlling investments, and certain real estate transactions. In Australia, filing fees in respect of FDI notifications were recently doubled with effect from 29 July 2022, with the highest applicable fee now reaching A$1.045 million.

The impact of any applicable 'standstill' obligations on the overall deal timetable will also need to be carefully factored into deal planning. Where completion is not suspended pending clearance, it is important to consider which party will take the regulatory risk and what the timing implications will be (particularly where various different FDI and merger control review processes are running in parallel). In some jurisdictions, the risk of a 'hold separate' order being imposed pending clearance, even if completion itself is permitted, will also need to be factored in.[28] Consideration should also be given to whether there are likely to be any active complainants and whether reverse break-fees reflecting regulatory risk are warranted.

If it is clear that national security concerns are likely to arise, it is also advisable to consider possible remedies upfront. These could be behavioural, such as restrictions on access to data, or structural, such as divestments. Consideration should also be given to adapting the structure of the transaction to assuage concerns, for example through the inclusion of domestic co-acquirers, a quota of domestic board directors, or a reduction in the level of control acquired. In cases where the concerns are not related to national security, even broadly defined, but rather the intentions of the acquirer in relation to rationalisation and the relocation of value-adding activities, offering undertakings on issues such as maintaining domestic investment, employment or even company headquarters may be helpful in securing approval. However, as noted above, where such commitments are given, acquirers should be careful that they believe that they will be able to comply with them.

Finally, it is vital to take a global and coordinated approach to assessing national security considerations and securing any necessary FDI clearances. Cooperation between FDI agencies (and the relevant national governments) tends to be a lot more informal and opaque than, for example, cooperation between competition authorities in the context of merger cases (which is often well established and governed by formal protocols for the exchange of information). However, it is certainly the case that FDI agencies do increasingly share information and consider possible coordination. In addition, a number of countries have started to coordinate more formally between their national competition authorities and FDI regulators. In Austria, for example, a recent amendment to the competition law includes a provision that obliges the competition authority to forward merger notifications to the Federal Minister for Digital and Economic Affairs (which oversees FDI notifications). In the UK, a formal memorandum of understanding has been agreed between the relevant government department and the national competition authority, setting out a framework for cooperation, coordination and information sharing in the operation of the new investment

screening regime contained in the National Security and Investment Act 2021. The authors are also aware of informal cooperation between merger control and FDI authorities taking place in the context of competition merger filings in other countries. Adopting a consistent approach to all regulators, particularly in more sensitive cases where remedies are likely to be required, will therefore be invaluable when trying to navigate numerous regimes in a cross-border transaction.

Notes

[1] Veronica Roberts is a partner, Ruth Allen is a professional support lawyer and Ali MacGregor is a senior associate at Herbert Smith Freehills LLP.

[2] The April 2022 edition of the regular OECD publication 'FDI in Figures' stated that global FDI flows grew by 88 per cent in 2021, 37 per cent above pre-pandemic levels (see: www.oecd.org/investment/investment-policy/FDI-in-Figures-April-2022.pdf).

[3] The European Commission has strongly encouraged those EU Member States that do not yet have an investment screening regime to adopt one, against the backdrop of the EU FDI Regulation (Regulation (EU) 2019/452). That Regulation does not impose an EU-wide screening regime, or require Member States to fully harmonise their domestic FDI regimes, but it does require existing regimes to be maintained or amended – and, in the case of new regimes, adopted – in accordance with a minimum set of requirements. The European Commission's second Annual Report on the screening of FDI into the EU (published 1 September 2022) helpfully summarises the swathe of changes that the EU FDI Regulation has triggered: 25 out of 27 EU Member States now either have a national FDI screening mechanism in place (amended to reflect the EU FDI Regulation where necessary), or have initiated a consultative or legislative process expected to result in the adoption of a new mechanism or amendments to an existing one. This includes the adoption of new screening mechanisms in the Czech Republic, Denmark and Slovakia, and new regimes anticipated in Belgium, Croatia, Estonia, Greece, Ireland, Luxembourg and Sweden. At the time of writing (September 2022), Bulgaria and Cyprus are the only EU Member States with no publicly reported FDI initiative under way.

[4] The proposed transaction was withdrawn after indications that the Australian authorities would not approve it.

[5] When reviewing the acquisition of UK chip designers Imagination by China-backed private equity group Canyon Bridge, the UK government focused on the implications for jobs, research and development, and the location of the headquarters of the company, but did not require any legally binding commitments in this regard.

[6] Chinese firm Cosco was initially limited to acquiring a 51 per cent stake in Piraeus Port, with a subsequent increase to 67 per cent conditional on the company completing its local investment programme.

[7] Italian shipmaker Fincantieri was permitted to take a 51 per cent controlling stake in French naval shipbuilder STX subject to 1 per cent of the equity being 'borrowed' from the French government. The government retained the option of taking back that stake, and control of the company, should the Italian company fail to meet its pre-acquisition commitments, which included the protection of jobs.

[8] *Broadcom/Qualcomm* involved a US-based acquirer, but the decision to block the transaction was based in part on concerns that the transaction could stall advancements in 5G technology in the United States and leave space for Chinese company Huawei to become the market leader for semi-conductors.

[9] In June 2021, the Biden administration revoked the August 2020 Executive Order relating to *Beijing Bytedance/TikTok* and called on US authorities to implement a more 'rigorous, evidence-based' process for identifying entities that pose 'unacceptable or undue risks' to US national security. One of the immediate effects of this was to eliminate the prohibitions on certain transactions with Bytedance contained in the August 2020 Executive Order. However, this action does not signal a shift in US authorities' focus.

[10] CFIUS Annual Report to Congress CY2020 and CY2021. See Table I-13 on page 36 of the 2020 report and page 32 of the 2021 report: Covered Transactions by Acquirer Home Country or Geographic Economy.

[11] Teledyne abandoned the proposed acquisition after the French government made it clear that FDI approval would be subject to extremely onerous conditions, which were unacceptable to Teledyne, including the French government retaining a 10 per cent shareholding in the target. In October 2020 it was reported that a new agreement in principle may have been reached in return for a 15 per cent price reduction, but the acquisition was formally prohibited on 18 December 2020.

[12] Under the EU Merger Regulation (Regulation (EC) 139/2004) the European Commission has exclusive jurisdiction to review transactions that meet certain turnover thresholds and have a 'Union dimension', subject to the right of EU Member States to take measures necessary to protect their 'legitimate interests', including national security.

[13] Communication from the Commission: Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation), announced on 25 March 2020, published in the Official Journal the following day (OJ C 99I, 26.03.2020, p. 1).

[14] Healthcare was expressly included in the list of sectors to which Spanish FDI reforms announced on 17 March 2020 apply.

[15] On 7 April 2020 the Italian government extended its powers to review FDI specifically in relation to acquisitions of 10 per cent or more by non-EU-controlled investors in a number of new sectors, including health.

[16] Amendments to the German FDI regime passed on 20 May 2020 expanded the list of business activities that trigger a mandatory filing for FDI from non-EU investors above a 10 per cent voting right threshold to include personal protective equipment, various medicinal products and in vitro diagnostics.

[17] Communication from the Commission: Guidance to the Member States concerning foreign direct investment from Russia and Belarus in view of the military aggression against Ukraine and the restrictive measures laid down in recent Council Regulations on sanctions (Council Regulation (EU) No. 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine (OJ L 229, 31.7.2014, p. 1) and its amendments and Council Regulation (EC) No. 765/2006 of 18 May 2006 concerning restrictive measures concerning restrictive measures in view of the situation in Belarus (OJ L 134, 20.5.2006, p. 1) and its amendments) OJ C 151I, 06.04.2022, p. 1.

[18] Details of the specified activities covered in each of the 17 sectors are set out in The National Security and Investment Act 2021 (Notifiable Acquisition) (Specification of Qualifying Entities) Regulations 2021. Accompanying guidance for investors was published on 15 November 2021 (updated 20 July 2022).

[19] Pursuant to the amendment of the Foreign Trade and Payments Act (AWG) adopted by the German parliament on 18 June 2020.

[20] Department for Promotion of Industry and Internal Trade, FDI Policy Section, Press Note No. 3 (2020 Series): Review of Foreign Direct Investment (FDI) policy for curbing opportunistic takeovers/acquisitions of Indian companies due to the current COVID-19 pandemic (17 April 2020). The new rules do not expressly specify the relevant countries, but it seems clear that prior approval will be required for investment into India from China, Nepal, Myanmar, Bhutan and Afghanistan, in addition to restrictions on investment from Pakistan and Bangladesh, which existed prior to the introduction of the new law. These additional restrictions were introduced following the acquisition of a 1 per cent stake in HDFC (India's largest mortgage bank) by the People's Bank of China.

[21] New Zealand was added to the list of 'excepted foreign states' with effect from 5 January 2022.

[22] The UK Secretary of State published a final statement on 2 November 2021 about how the government intends to exercise the call-in power under the National Security and Investment Act 2021. This expressly states that the government does not regard state-owned entities, sovereign wealth funds, or other entities affiliated with foreign states, as being inherently more risky from a national security perspective.

[23] Sepura Ltd is a UK company that manufactures radio devices used by emergency services. When it was acquired by the Chinese company Hytera Communications Corporate Limited in 2017, the UK government required legally binding undertakings to resolve national security concerns under the public interest merger regime that was then in force. The subsequent sale of Sepura Ltd to Epiris Group (a UK-based private equity firm) in 2022 was reviewed under the new National Security and Investment Act 2021, which resulted in similar undertakings being required in respect of the operation of Sepura Ltd under the ownership of Epiris Group.

[24] Regulation (EU) 2019/452 (see footnote 3).

[25] In the UK, the National Security and Investment Act 2021 grants the government retroactive powers to call in for review any qualifying transaction completed between 12 November 2020 and 4 January 2022 (the commencement date of the new regime). In the Netherlands, a new FDI regime was adopted in May 2022. It has not yet entered into force at the time of writing

(September 2022), but it is intended to have partial retroactive effect in respect of transactions completed on or after 8 September 2020.

[26] As part of the reform package introduced in Australia on 1 January 2021, the maximum term of imprisonment for non-compliance has been extended to 10 years (compared to five years in both the United Kingdom and Germany).

[27] The text of the decision is not yet publicly available at the time of writing (September 2022).

[28] The authors are aware that this approach has been taken in at least one recent case in the United Kingdom.

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