Europe doubling down on foreign takeovers amid COVID-19 crisis

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The disruption linked to COVID-19 already affects the global economy significantly, including M&A transactions in Europe and across the globe. On the regulatory side, many deals face challenges caused by national authorities' reduced capacities, while some authorities struggle to uphold business as usual. On the other hand, concerns about investors taking advantage of the volatility or undervaluation of European stock markets by acquiring valuable assets are widespread in Europe. Against this backdrop, the European Commission published a guidance note "to ensure a strong EU-wide approach to foreign investment screening" in the current crisis, while various Member States have already increased scrutiny or even prohibited certain foreign takeovers.

On 25 March 2020, the European Commission (Commission) issued **guidance to EU Member States concerning foreign direct investment (FDI) and the protection of Europe's strategic assets during the COVID-19 crisis (Guidance)**. The guidance is available here, and the accompanying press release is available here. The Commission calls on Member States to preserve companies and assets from foreign takeovers in the current public health crisis, without undermining the EU's general openness to foreign investment.

The Commission singles out the healthcare sector as particularly vulnerable due to the COVID-19 crisis. However, the scope of the Guidance is much broader and relevant to parties in M&A transactions in all strategic sectors involving non-European acquirers:

> "*FDI screening should take into account the impact on the European Union as a whole, in particular with a view to ensuring the continued critical capacity of EU industry, going well beyond the healthcare sector. The risks to the EU's broader strategic capacities may be exacerbated by the volatility or undervaluation of European stock markets. Strategic assets are crucial to Europe's security, and are part of the backbone of its economy and, as a result, of its capability for a fast recovery.*"

The Guidance follows the imposition of restrictions on the export of certain personal protective equipment (PPE) to counter the COVID-19 crisis, adopted by the EU on 19 March 2020 (see here for our coverage of the measures).

The EU Guidance and FDI Framework Regulation

To address the issue of takeovers by non-EU investors of EU companies in sensitive and strategic sectors, the EU adopted Regulation (EU) 2019/452 of 19 March 2019 (available here) (the FDI Framework Regulation). The FDI Framework Regulation is intended to ensure the protection of legitimate public policy objectives and national security if these are threatened by takeovers by non-EU investors. The FDI Framework Regulation will become fully applicable on 11 October 2020. Furthermore and as opposed to merger control, the responsibility for screening FDI ultimately rests with Member States. The FDI Framework Regulation mainly provides principles and structures for communication and coordination regarding FDI between the EU and Member States in cases where interests of the EU or its Member States are affected (see here for our latest coverage and more information on the FDI Framework Regulation).

Within the said framework and in anticipation of it becoming fully applicable, the newly adopted Guidance urges Member States to be "***particularly vigilant to avoid that the current health crisis does not result in a sell-off of Europe's business and industrial actors, including small and medium-sized enterprises (SMEs)***", **which are crucial to Europe's security and its capability for a fast recovery**.

Specifically, the Commission calls on Member States to:

a) **make full use of the mechanisms of the FDI Framework Regulation** and to take fully into account the risks to critical health infrastructures, supply of critical inputs, and other critical sectors if national screening mechanisms are already in force; and

b) **for those Member States which currently do not have a national screening mechanism**, or whose screening mechanisms do not cover all relevant transactions, **set up a full-fledged screening mechanism. In the meantime, such Member States should use all other available options** to address cases where the acquisition or control of a particular business, infrastructure or technology would create a risk to security or public order in the EU, including a risk to critical health infrastructures and supply of critical inputs.

The Guidance also identifies measures that Member States can take with regards to investments that do not constitute FDI, i.e. portfolio investments, such as retaining special rights ("golden shares") to block or set limits to certain types of investments in the companies concerned.

Developments and overview of FDI rules in the 27 Member States and the UK

Member States continue to review FDIs on the grounds of security or public order, and to take measures to address specific risks. **These risks, as explained in the Guidance, include threats linked to a public health emergency**. Pursuant to the FDI Framework Regulation, the review and, when required, the adoption of measures preventing or conditioning an investment on grounds of security or public order is the ultimate responsibility of Member States. The Commission may address opinions recommending specific actions to the Member State when there is a risk that the investment affects projects and programmes of Union interest. Member States may also chime in if they see their interests affected by FDI into other Member States.

To date, 14 of the 27 Member States have adopted mechanisms to scrutinise FDI, ranging from screening procedures to partial or total prohibition of FDI in specific sectors. Among these countries are Europe's largest economies – including France, Germany, Spain and the UK – all of which recently tightened their FDI screening regimes (a full list of Member State screening mechanisms is available here). Following a global trend in recent years, even European countries that are traditionally recognized as the most open economies, such as the Netherlands, are in the course of adopting or considering FDI screening regulations. The COVID-19 outbreak is likely to accelerate this process significantly and companies should prepare for a tougher M&A level playing field post-crisis.

Individual measures taken

Various EU Member States have already announced that they will intervene to protect their strategic assets by blocking FDIs in view of the current COVID-19 public health crisis in Europe. In particular, southern European countries aim to avoid losing important economic assets after the economic crisis:

- In **Spain**, Royal Decree-law 8/2020 of 17 March 2020, as last amended by Royal Decree-law 11/2020 of 31 March 2020, sets out urgent measures to deal with the economic and social impact caused by the COVID-19 crisis.

  These measures subject acquisitions of stakes in Spanish companies operating in specific strategic sectors to prior authorization, provided that the stake is equal to or exceeds 10% of the share capital or entails effective participation in the management or control of the Spanish company, and the investor: (i) is based outside the EU and the European Free Trade Association (EFTA); or (ii) is based in the EU/EFTA but its beneficial ownership (i.e., a stake exceeding 25% of the share capital or voting rights, or direct or indirect control by any other means) is held, directly or indirectly, by a non-EU/EEA entity.

  The strategic sectors covered by these new measures include critical infrastructures (such as energy, transport, water, health, media, data processing or storage, aerospace, defence); critical technologies and dual-use products (such as artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, nanotechnologies and biotechnologies); supply of fundamental inputs (particularly energy, raw materials, food safety); and sectors with access or control of sensitive information such as personal data and media.

  The covered sectors can be further expanded for reasons of public security, public order and public health. Further, a prior authorization would be required for the acquisition of any assets in the following scenarios: (i) the foreign investor is directly or indirectly controlled by the government of a third country; (ii) the foreign investor has made investments or participated in activities in sectors that affect safety, public order and public health in another Member State; and (iii) there are on-going administrative or legal proceedings concerning unlawful or criminal activities against the foreign investor in another country.

  New developments to the FDI legal framework aimed to exempt the prior authorization requirement for acquisitions below a certain threshold are expected in the next weeks. Until then, an expedited procedure before the Directorate General of International Trade and Investment of the Ministry of Industry, Trade and Tourism (prior report from the Board of Foreign Investments) is applicable to: (i) acquisitions where there is an agreement or binding offer with a price determined before 18 March 2020; and (ii) acquisitions for an amount between EUR 1 to EUR 5 million. Further acquisitions below EUR 1 million are exempted from prior authorization.

These new rules will be applicable during the term of the national emergency and possibly thereafter. Further information on some of the Spanish emergency measures is available here.

- In **France**, in time of crisis the Government has the legislative powers to increase its interests in strategic companies, or even acquire control of strategic companies if it passed specific laws in this regard. At time of writing, however, the Government has not announced any intention to nationalise specific companies, although it is monitoring the situation very closely. Separately from the nationalisation speculations, the Government has confirmed that its current rules on FDI screening approvals are designed to prevent any foreign acquisition or minority ownership in strategic sectors of the French economy from causing national security concerns. Independent of the crisis, the French Parliament has already approved a tightening of the current regime, which enters into force on 1 April 2020.

- In **Italy**, Prime Minister Conte affirmed on 25 March 2020 that the government is "*ready to act to defend the industrial and business assets of our country without precluding [the Italian Government] from expanding the intervention to other strategic sectors*". Prior to that, the government had already started to defend strategic companies, in the energy and aerospace sectors. For ongoing FDI screening procedures, review periods have already been suspended until 15 April 2020.

- **Germany** has not adopted any specific measures regarding the crisis yet. However, we have recently experienced increased scrutiny and delays in ongoing screening procedures by the German Federal Ministry of Economics to address concerns of foreign takeovers taking advantage of the crisis. Independent of the crisis, a far reaching reform to tighten the existing rules for FDI screenings is being proposed and currently under discussion by the government (see our previous coverage of the reform here). The reform is aimed to adapt the German legal framework to the coordination system introduced by the FDI Framework Regulation.

- The **UK** has not publicly announced any specific measures in relation to FDI screening regarding the crisis yet. However, a number of changes to the UK national security landscape have been implemented to strengthen the UK Government's powers and to allow for intervention in certain categories of transactions (see our previous coverage of the UK reforms here). Although the current regime is voluntary, the UK Government can ultimately block a transaction in strategic sectors of the UK economy if the deal raises national security concerns.

The above measures reflect the situation in the EU on 31 March 2020. Companies affected by these measures should remain vigilant to any further developments.

Key takeaways

The COVID-19 crisis intensifies an ongoing trend in major Western economies such as the US, Japan, as well as France, Germany, Spain, the UK, and others in Europe to tighten FDI. Generally speaking, government intervention under FDI screening rules is already much harder to predict than government intervention under the long-established merger control regimes, particularly as the security concerns associated with FDI are often not communicated or discussed openly during the review process. Such difficulties for transaction parties will likely further increase in the wake of the crisis.

Companies can expect authorities to widely remain active and closely follow FDIs into their respective economies. Concerns about investors taking advantage of the crisis by acquiring valuable assets are widespread in Europe and will likely result in authorities making full use of their screening powers – as in France – or even expand their existing screening powers – as in Spain and potentially Italy. Additionally, the vocal engagement of the EU has raised awareness of these issues across the EU, even in Member States which are so far coping comparably well with the crisis, such as Germany.

Authorities may require more detailed explanations and further documentation as to the rationale of foreign takeovers, in order to seek reassurance that the current crisis is not being exploited. Even in cases where transactions have been envisaged long before the crisis, companies may still face increased scrutiny.

If the crisis continues to worsen, FDI review periods could also be suspended in other countries, in line with Italy. Where possible, reviews might also be delayed or postponed. Particularly in the case of ongoing transactions, companies need to closely monitor the developments in order to avoid or mitigate negative impacts on deal timelines.

While UNCTAD has already predicted FDI to potentially shrink by 5 to 15% due to the crisis (see here), the measures will likely not be suitable to ease the impact on companies planning cross-border transactions.

Read our previous blogs on related topics here:

- Newsletter – News, regulation and effects of the COVID-19 crisis, HL Madrid
- The EU and various member states measures on Personal Protective Equipment in response to the COVID-19 outbreak
- Industrial policy strikes again: Germany announces further tightening of Foreign Investment Control rules
- Foreign Investment Control on the Rise – New List of EU Member States' FDI Screening Mechanisms
- New EU rules for foreign direct investment screening: One step closer to adoption and entry into force
- The Foreign Investment Regulation Review: EU Overview
- We are the champions – France and Germany unite to revive industrial policy at European level
- A New European Deal? – German Minister of Economics suggests revising EU and German merger control regulations to enable the creation of European champions – and keeps FDI options on the table to prevent acquisitions by non-European players
- No Christmas Presents for Foreign Investors: The German Government tightens regulations on Foreign Investment Control (again) and amends the anti-boycott provision
- Chinese walls? Germany reinforces the control of foreign investments
- U.S. Treasury Department issues final CFIUS regulations

- New UK foreign investment screening rules come into force

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