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Is national security a game changer for foreign investment control regimes and M&A transactions in Europe?

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Governments all over the world are continuing to take steps to strengthen their powers to intervene in foreign direct investments ("FDI") into their countries. These changes come at a time of increased scrutiny of foreign takeovers by governments across the globe, as economic protectionism continues to rise, while the long term response to the coronavirus pandemic is still cautiously unfolding.

This means that investors can now expect to encounter more scrutiny by respective governments and face a prolonged approval process when entering into deals. 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 FDIs are often not communicated or discussed openly during the review process. Foreign investors and parties in M&A transactions should be mindful of various requirements to provide detailed information to regulators. This could potentially impact the timing of transactions where additional regulatory notifications and authorisations may be required.

These risks of governmental intervention into deals are now commonly framed into a "national security" narrative interpreted in a much broader economic sense, and focused on sectors regarded as "strategically" important to a given state, in which a new investment may give rise to national interest issues. These are now expanding well beyond the traditional "national security" realm to include sectors such as public health, dual-use sectors, semi-conductors, cybersecurity, and high-tech industries. In addition to extending the number of sectors subject to FDI reviews, a number of European legislative reforms are also aimed at strengthening regulators' enforcement powers.

To date, 14 EU Member States and the UK have in place mechanisms for vetting FDI on security and public order grounds[1], while other Member States, such as Belgium and Greece, are in the process of adopting their own FDI screening procedures. In addition, the EU has amended the EU FDI Framework Regulation with the expansion of the scope of programmes of interest to the EU that are subject to screening. The amendments are expected to enter into force prior to the EU Framework Regulation becoming fully applicable on 11 October 2020. To this end, the Directorate General for Trade of the European Commission has just created a unit to deal with FDI screening within Directorate F4, Technology and Security, FDI Screening.

Further, various Member States are amending their current FDI review regimes.

By way of example, the French government recently expanded the range of 'sensitive activities' subject to its FDI regime to include the "biotechnology" sector, while Germany has proposed to extend the list of critical business activities triggering a mandatory filing. Germany has also passed the second of three planned reform steps of German FDI rules that will have an immediate impact, in particular with respect to M&A transactions in the field of critical infrastructure, and later in the year likely also “critical technologies” more broadly. As a very important procedural change, any acquisition subject to reporting requirements will now be subject to a stand-still obligation for the duration of the investment control procedure.

In the UK, the government announced the National Security and Investment Bill at the end of last year, setting out a proposed "longer-term" reform of the foreign investment control regime, which includes the creation of a standalone FDI screening review process, and a significant increase in the government's powers to scrutinise investments on national security grounds.

What does this mean for you?

Navigating through these laws is challenging, yet essential when conducting global M&A transactions. The table below sets out a high-level overview of the European foreign direct investment screening mechanisms for France, Germany, Italy, Spain and the UK, including information on recently implemented or pending amendments introduced either as an effort to mitigate the potential effects of the COVID-19 pandemic or, more generally, to tighten up national FDI screening regimes.

[1] These Member States are: Austria, Denmark, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, the Netherlands, Poland, Portugal, Romania and Spain.

Jurisdiction	Overview of applicable FDI Rules	Updates to FDI regime
EU	• The EU does not operate an EU-wide FDI screening system. On 11 April 2019, Regulation 2019/452 (the "**FDI Screening Regulation**") came into force, and becomes fully applicable as of 11 October 2020, and sets out a basic framework of rules and minimum requirements for Member States' FDI screening mechanism, so that they are able to assess whether FDI is likely to affect security or public order. • Member States retain full discretion as to whether they choose to implement an FDI screening regime. However, more Member States are now in the process of preparing / adopting FDI vetting mechanisms and it is expected that by mid-2021 most, if not all, Member States would have their own procedures. • Member States must submit annual reports to the European Commission. • Member States must also notify the European Commission and other Member States of FDI in their territories. In response, the European Commission and other Member States will be able to issue opinions and sub-comments on another Member States' FDI screening where it considers such an investment is likely to affect security or public order. • The European Commission will also be able to issue an opinion where an investment could undermine a project or programme of interest to the EU listed in an Annex to the FDI Screening Regulation.	• In March 2020, the European Commission issued guidance to EU Member States concerning FDI and the protection of Europe's strategic assets during the COVID-19 crisis. • Specifically, the European Commission called on Member States to make full use of the mechanisms of the FDI Framework Regulation; and 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. The EU programmes subject to screening has been amended through a Commission Delegated Regulation of 13 July 2020 to include within Horizon 2020 also R&D programmes and joint undertakings; the Permanent Structured Cooperation (PESCO) will also cover security and defence projects; and three new programmes: (1) the Preparatory Action on Preparing the new EU Governmental Satellite Communications (GOVSATCOM); (2) the Preparatory Action on Defence Research; and (3) the European Joint Undertaking for International Thermonuclear Experimental Reaction (ITER). These amendments will enter into force prior to the EU Framework Regulation becoming fully applicable on 11 October 2020.
France	• Certain foreign investments carried out in business sectors that are deemed sensitive may be subject to prior authorisation from the Ministry of Economy ("MoE"). • A transaction will trigger prior authorisation when three cumulative criteria are met: o Origin of the investor – On 1 April 2020, the definition of the foreign investor has been clarified o Nature of investment operation : • Acquisition of control • Acquisition of a line of business o Acquisition of more than 25% of capital shares or voting rights (only for investors outside EEA) • Sensitive activities of the targeted company include: defense activities, energy, transport, public health, electronic communications, new technologies, aerospace, data centers - as from 1 April 2020, media and food safety fall within the scope of the screening	**Extended range of 'sensitive activities'** • The French government introduced further reforms to its FDI review regime, which entered into force in April 2020. In particular, the range of 'sensitive activities' has been widened, and the acquisition threshold lowered from 33.33% to 25%. **Strengthened enforcement powers of the MoE** • In May 2019, a new set of measures were introduced to strengthen the MoE's powers to impose sanctions on companies when a transaction has been implemented without prior authorisation. **COVID-19** • Following the COVID-19 outbreak, the French government added biotechnologies to the list of sensitive activities and announced that it would lower the acquisition threshold to 10% until the end of 2020, only for listed companies, which have sometimes dispersed ownership and for which minority shareholding can be destabilising if unfriendly.

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Germany	• The Ministry of Economy (MoE) is able to review and block acquisitions of German companies by non-EU/ EFTA, and in some cases even by any foreign acquiring companies if they threaten national security or public order. • A transaction may trigger a cross-sector investment review if the following thresholds are met (1) a non-EU/ EFTA investor acquires ownership of at least 25% of the voting rights in a Germany company; or (2) a non-EU/ EFTA investor acquires ownership of at least 10% of the voting rights in a Germany company that operates in a "critical infrastructure" sector or if it provides other services of particular relevance to security. • A transaction may trigger a sector-specific investment review if any foreign investor (including EU/EFTA) acquires 10% or more of the voting rights in a German company that: manufactures or develops military weapons or certain parts thereof; manufactures or develops specifically identified military equipment; or manufactures cryptographic systems for the State's use of classified information.	**Increased MoE powers** • Following the COVID-19 outbreak, Germany has tightened its investment screening for companies producing vaccines, drugs, protective equipment and other products related to infectious diseases and to intervene when a non-EU investor buys 10% or more of German company shares. • In June 2020, the German Parliament approved the amendment of the Foreign Trade and Payment Act, in order to align it with the framework introduced by the EU FDI Framework Regulation. The amended law is expected to come into force during the summer. • Germany has announced to add additional industries into the scope of the Foreign Trade and Payment Regulation later this year. This will likely include "critical technology" as mentioned in the EU FDI Framework Regulation. The exact scope of the new Regulation is yet to be seen.
Italy	• Pursuant to the Italian FDI rules, the filing obligation is mandatory and the notification must be made in relation to any acquisition of interests in a target company active in one of the relevant sectors by a foreign investor. • Relevant sectors include: defence and national security (for both EU/EEA and non-EU/EEA investors); and in relation to specific assets in the fields of 5G technology, energy, transport and telecommunications (for non-EU/EEA investors only). • The Presidency of the Council of Ministers (PCM) will review a transaction to primarily determine whether the proposed transaction poses a risk to public order or poses a danger to public security.	**COVID-19** • In April 2020, following the COVID-19 outbreak, Italy expanded on a temporary basis until 31 December 2020 its FDI powers to include new sectors (i.e. critical infrastructures, critical technologies, critical input and access to sensitive information and media) and to increase the type of operations requiring approval. In particular, Italian FDI rules now apply to: o acquisitions of controlling interests in all the strategic sectors by EU/EEA entities; o acquisitions of at least 10% shareholding in al strategic sectors by any non-EU/EEA entity in an investment of at least EUR 1 million. • The aforementioned provisions will apply until 31 December 2020 to all cases in respect of which the notification obligation arises during the period at hand producing, in any case, stable effects over time also once the sunset rule application term expires. Thereafter implementing regulations identifying the strategic assets will have to be adopted by the Italian Government. • It is now provided also the permanent possibility for the Italian Government to initiate FDI review independently and in the absence of a filing.

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Spain	• Transactions relating to certain sectors are subject to prior authorization prior to the investment. These are: 1. National defence: foreign investments directly related to national defence, such as the manufacture or trade of weapons, ammunition, explosives and military equipment or if the target of the investment is involved in contracts or relations with the Spanish Ministry of Defence or its bodies or the Spanish national defence industrial sector. • Investments made by non-Spanish persons or entities through (i) acquisition of stakes or voting rights in a Spanish company (except if the investment is made in listed companies and is equal to or below 5% of the share capital of the Spanish target, or does not allow the foreign investor to directly or indirectly become part of the management bodies); (ii) acquisition of real estate in Spain exceeding EUR 3,005,060.52; or (iii) incorporation of, or participation in, other entities or joint ventures exceeding EUR 3,005,060.52. • Foreign investments in national defence field require prior authorization from the Council of Ministers after processing of the application by the Ministry of Defence and after the relevant report issued by the Board of Foreign Investments. 2. Regulated sectors: • Investments in financial services companies, such as credit entities, insurance companies and investment vehicles. • Gambling, air transportation and energy also have further sector-specific authorisation procedures.	**Expanded scope of 'strategic sectors'** • In March 2020, Spain extended its FDI screening mechanism when a foreign investor buys 10% or more of Spanish company shares or acquires effective participation in the management or control of the Spanish company to cover 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 list of public sectors can be further expanded on grounds of public security, public order or public health. **Other criteria for screening** • Investor is directly or indirectly controlled by a non-EU Government; • Investor has made investments or participated in activities affecting safety, public order or public health in another Member State; • Ongoing administrative proceedings concerning unlawful or criminal activities against the investor in another country. **Expanded scope of 'foreign investor'** • In April 2020, EU /-EFTA investor with a beneficial ownership exceeding 25% share capital or voting rights outside the EU/EFTA are 'foreign investor'. **Threshold** • Acquisition of 10% or more of the share capital or participation in the management or control of the Spanish company. • Acquisitions below EUR 1 million exempted.

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UK	• The UK does not yet operate a standalone FDI screening process, but the UK government via the Secretary of State can intervene in certain categories of transactions under the current UK merger control regime, where any of the "public interest" grounds are met (including national security, media plurality, financial stability, and public health emergencies). • Transactions will be caught if they constitute a "relevant merger situation", where either: - (1) the UK turnover associated with the enterprise being acquired exceeds £70 million; or - (2) the transaction creates or enhances a 25% share of supply or purchases of any goods or services in the UK, or in a substantial part of it. • However, lower thresholds have been introduced where enterprises are active in one of a number of "relevant sectors", which include, inter alia, the military and dual-use sectors, the quantum technology sector and the computing hardware sector. • The thresholds in such cases require: - (1) the enterprise being acquired to have turnover in the UK of more than £1 million; or - (2) the target company alone has a share of supply or purchase of goods or services in the UK of at least 25%.	**Amendments to merger control thresholds** • In June 2018, the powers of the government to intervene in mergers were expanded to include transactions in the military and dual-use, computing hardware and quantum technology sectors in the UK by reducing the merger thresholds for transactions in these sectors. **New legislation relating to national security** • In December 2019, the National Security and Investment Bill was announced. The proposed legislation will ensure that the UK government has greater oversight over transactions that raise national security concerns, by giving the UK a standalone national security review process outside of the existing competition law regime. **COVID-19** • New measures, which came into force on 23 June 2020, will allow the UK Government to intervene in relation to transactions involving businesses with "critical capabilities" to help combat public health emergencies. **Lower thresholds for certain technology sectors** • The Government has also set out proposed changes to the merger control thresholds in relation to transactions in the sectors of artificial intelligence, cryptographic authentication technology and advanced materials. For transactions in these three sectors, the CMA will have the ability to intervene where (1) the target's turnover exceeds £1 million (reduced from £70 million); and/or (2) the target alone has a share of supply or purchase of at least 25%.These changes are expected to come into effect shortly.

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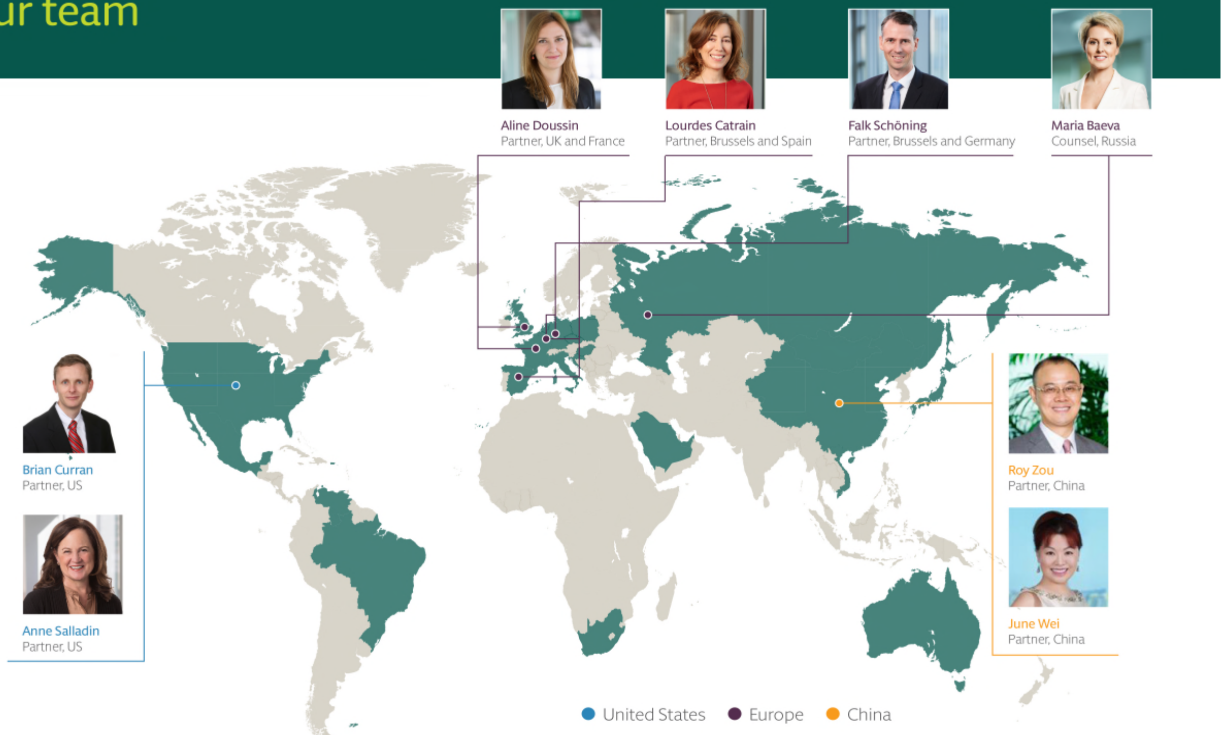

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