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Regulation of foreign direct
investment on the rise in Europe

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Through Aerospace and Defense Insights, we share with you the top legal and political issues affecting the aerospace and defense industry. Our A&D industry team monitors the latest developments to help our clients stay in front of issues before they become problems and seize opportunities in a timely manner.

Mergers and acquisitions in the aerospace and defense industries, like many other industries, have slowed due to the impact of the COVID-19 pandemic and related economic downturn. But the effect of the downturn is not uniform across this diverse industry and it has not halted all mergers and acquisitions. To the extent transactions continue, acquirers and sellers should anticipate increased regulation of foreign investments by the EU and EU member states. Foreign investment control screenings have become an important consideration when structuring deals and planning for regulatory review. We expect future deals in the industry to be shaped by enhanced foreign investment regulations. New and enhanced foreign investment regimes have already been adopted by a growing number of jurisdictions and we are already seeing this reflected in our deal practice. A review of recent developments in the EU and in EU member states follows.

EU guidance on foreign direct investment (FDI) and FDI framework regulation

An increasing number of European jurisdictions have introduced rules restricting FDI or have recently strengthened existing rules. This trend accelerated with the emergence of the COVID-19 crisis. The disruption linked to COVID-19 has widely fueled concerns about investors taking advantage of the volatility or undervaluation of European stock markets by acquiring valuable assets. Against this backdrop, on 25 March 2020, the European Commission (Commission) issued guidance to EU member states concerning FDI and the protection of Europe's strategic assets during the COVID-19 crisis (Guidance).¹

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 counsels that transactions in all strategic sectors involving non-European

acquirers should prompt FDI screening and instructs that such screenings 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 adoption of Regulation (EU) 2019/452 of 19 March 2019 (the FDI Framework Regulation), which will become fully applicable on 11 October 2020.² 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. Although the responsibility for screening FDI rests with member states, the Commission may issue opinions recommending specific actions to the member state when there is a risk that the investment affects “*projects and programs of Union interest*.” Member states may also chime in if they see their interests affected by FDI into other member states.

Within this framework and in anticipation of it becoming fully applicable, the Guidance urges member states to be particularly vigilant in preventing the COVID-19 crisis from resulting in sell-off of Europe's business and industrial actors, including small- and medium-sized enterprises, “*which are crucial to Europe's security and its capability for a fast recovery*.” 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. The mentioned “*strategic capacities*” and “*strategic assets*” addressed by the Guidance will particularly include the aerospace and defense industries. These industries have, to varying extents, already been subject to FDI review in a number of jurisdictions and scrutiny can be expected to further increase.

FDI developments in the EU member states and the UK

To date, 15 of the 28 member states and the UK have adopted mechanisms to scrutinize FDI, ranging from screening procedures to partial or total prohibition of FDI in specific sectors. Among these countries are Europe's largest economies – Germany, the UK, France, Italy and Spain,³ – all of which recently tightened their FDI screening regimes. Even European countries that are traditionally recognized as the most open economies, such as the Netherlands and Switzerland, are considering or adopting FDI regulations.⁴

Transactions in the defense industry as well as those involving “*critical infrastructure*” – typically defined to include energy, water, telecommunications, healthcare, transportation, and certain IT and finance infrastructures – commonly draw FDI scrutiny. As a result of stronger FDI regulations adopted by many European countries, aerospace and defense companies should expect increased scrutiny of any merger or acquisition that targets a European company. Importantly, FDI screenings not only extend to situations where fully assembled products or facilities are in question, but are also used to scrutinize investments in companies that make equipment or spare parts or are a significant

1. The guidance, which calls on member states to preserve companies and assets from foreign takeovers, without undermining the EU's general openness to foreign investment, is available on the Commission's website under https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf.

2. The Regulation is available under <https://eur-lex.europa.eu/eli/reg/2019/452/oj>.

3. See in more detail below. Other member states with FDI screening mechanisms are Austria, Denmark, Latvia, Lithuania, Hungary, Poland, Portugal, Romania, Slovenia and Finland. A list of FDI regimes notified by member states to the EU can be retrieved on the European Commission's website under http://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf.

4. The Swiss Federal Council has blocked a motion to introduce foreign investment control. Documentation is available on the Federal Council's website under <https://www.parlament.ch/de/ratsbetrieb/>

[suche-curia-vista/geschaefte?AffairId=20183021](https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaefte?AffairId=20183021). Last year, a report was published expressly advising against the introduction of a general FDI regime: <https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaefte?AffairId=20183233> (both only in German, French, and Italian). Meanwhile, the Dutch government is preparing certain regulations providing for FDI screenings for national security reasons to be introduced in the future. Assessments are made on a sector by sector basis, while legislation for the telecommunications sector is already underway. Further, the Dutch government announced in 2019 that in 2020 a draft bill for consultation would be presented introducing a broader national security screening.

subcontractor in sensitive sectors. This may, under certain circumstances, extend to the manufacturing of products or machinery specifically designed for a use relating to other covered products. An example of this is the German federal government’s decision in 2018 to block the proposed acquisition by a Chinese investor of Leifeld Metal Spinning, a German manufacturer of metal forming machines used in the automotive, aerospace, and nuclear industries, which did not produce or assemble vehicles, airplanes, power plants or parts thereof itself.

Individual measures taken

European states continue to review FDI on the grounds of security or public order and to take measures to address specific risks. Additionally, various EU member states have adopted reforms enabling them to intervene to protect their strategic assets by blocking FDI in view of the current COVID-19 public health crisis in Europe, but also based on the general trend towards tighter regulation of FDI. A few recent developments include:

- **Germany** has been at the forefront of the EU member states concerning, in particular, the screening of Chinese investments, although the number of notified acquisitions by U.S. acquirers has also increased. The German regulatory framework continues to evolve quickly and two of three planned reform steps of German FDI rules for 2020 have been finalized. These reforms follow a prior FDI reform package implemented in December 2018. After implementing specific safeguards in the health sector in light of the COVID-19 crisis on 20 May 2020 by revising the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung* – AWV), the underlying Foreign Trade and Payments Act (*Außenwirtschaftsgesetz* – AWG), has also been amended.⁵ The new rules will immediately impact M&A transactions in the field of critical infrastructure, and as of later in the year likely also “critical technology” more broadly. Any

5. The amendment is publicly available in German under https://www.bmwi.de/Redaktion/DE/Downloads/F/fuenfzehnte-verordnung-zur-aenderung-der-aussenwirtschaftsverordnung-vo-bundesregierung.pdf?__blob=publicationFile&v=4. The German Foreign Trade and Payments Ordinance and Act are publicly available in German under https://www.gesetze-im-internet.de/awv_2013/BJNR286500013.html and https://www.gesetze-im-internet.de/awg_2013/BJNR148210013.html.

acquisition subject to reporting requirements will now be subject to a stand-still obligation for the duration of the investment control procedure. Previously, only transactions in the defense industry were subject to a **stand-still obligation** that prevented such transactions from closing during the review procedure. The same obligation now extends to transactions involving critical infrastructure such as energy grids or telecommunication networks. The revised German law also changes the **screening standard**; in the future, it is sufficient for the government to find that an acquisition is “likely to affect public order or security in Germany.” Previously, an “actual threat” had been required. As a result of this change, critical infrastructure acquisitions in the future could be examined in a more “forward-looking” manner.

- In the **UK**, a 2018 reform of the Enterprise Act 2002 introduced lower merger control thresholds for transactions in certain sectors especially relevant to the aerospace and defense industry, such as dual-use, where the target turnover threshold was reduced to as little as GBP 1 million from previously GBP 70 million. As the FDI regime in the UK is linked to merger control, enabling the state secretary to intervene in a merger procedure on national security considerations, these revised thresholds are designed to provide the UK government with increased scope to scrutinize FDI and transactions that raise national security concerns. As a result of the COVID-19 crisis, on 23 June 2020 further amendments entered into force, allowing the UK government to intervene in acquisitions to protect the UK’s capability to combat, and mitigate the effects of a public health emergency. In addition, the changes expand powers to scrutinize and intervene in mergers related to AI, cryptographic authentication technology, and advanced materials.⁶ The UK government also announced the National Security and Investment Bill in December 2019, which is supposed to eventually create a standalone FDI regime.

html. English versions are also available, but have so far not been updated to reflect the latest reforms.

6. See the UK governments press release on the topic under <https://www.gov.uk/government/news/new-protections-for-uk-businesses-key-to-national-security-and-fight-against-coronavirus>.

- **France** is another driver of growing restrictions on FDI in Europe. French FDI rules, laid out in Article L. 151 et seq. *Code monétaire et financier* and further decrees, cover an extensive range of sectors and subjects deals to stand-still obligations prior to clearance.⁷ Covered sectors include defense and – in line with the FDI Framework Regulation – energy, transportation, public health, space and aircraft industries, telecommunications, storage of sensitive data, dual-use goods and technology, media, and food safety. Critical technologies are covered, including activities related to cybersecurity, AI, robotics, semiconductors, additive manufacturing, quantum technology, energy storage, and biotechnologies. The French rules have been amended several times in recent years. In France, the government (permanently) added biotechnologies to the list of sensitive sectors and temporarily lowered the review threshold following the COVID-19 crisis.⁸ Independent of the COVID-19 crisis, a tightening of the current regime and implementation of the FDI Framework Regulation entered into force on 1 April 2020,⁹ following a previous reform in December 2019.
- 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, and subsequently Italy enacted new FDI screening rules on 8 April 2020 with Law Decree No 23 of 2020. The new law amends the governments so-called Golden Powers by significantly extending the sectors deemed strategic and of national interest and also prolonging review deadlines.

7. Article L. 151 Code monétaire et financier is available in French under <https://www.legifrance.gouv.fr/affichCodeArticle?cidTexte=LEGITEXT000006072026&idArticle=LEGIARTI000006645694&categorieLien=id>. A general overview of the French FDI rules is available under <https://www.tresoreconomie.gouv.fr/Articles/84d2a0ee-c6f4-4e3a-9dfb-3e048b7f76b8/files/3a44e5f8-2ef5-43d1-9243-6bef3d9be0e4>.

8. See the press release of the Ministère de l'Économie, des Finances et de la Relance under <https://www.tresoreconomie.gouv.fr/Articles/2020/04/30/covid-19-update-of-the-foreign-direct-investment-screening-procedure-in-france>.

9. Available in French under <https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000039727569&categorieLien=id>.

Importantly, Italy provides for a deadline for FDI notifications of ten days after signing or exercising an option to acquire. Covered sectors now include defense and national security, 5G technology, energy, transport, communications and relevant sectors pursuant to art. 4 (1) of the FDI Framework Regulation.¹⁰ Foreign investment control in Italy is governed under numerous Italian laws.¹¹

- In **Spain**, Royal Decree-law 8/2020 of 17 March 2020, as amended by Royal Decree-law 11/2020 of 31 March 2020 and last amended by Royal Decree-law 26/2020 of 7 July 2020, set out “urgent measures to deal with the economic and social impact caused by the COVID-19 crisis.”¹² These measures subject acquisitions of stakes in Spanish companies operating in specific strategic sectors by a non-EU/EFTA investor to prior authorization. The strategic sectors covered by these new measures mirror those identified in the FDI Framework Regulation and include critical infrastructures, critical technologies and dual-use products, supply of fundamental inputs 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. Given the broad nature of these sectors, it has become customary in Spain to at least informally discuss with the Spanish government whether a planned transaction falls into the scope of the revised FDI rules.
- Until recently, FDI screenings have not been established in most of the countries of Central Eastern Europe. But this has started to change with **Austria, Hungary, Poland, and Slovenia** all recently introducing new or modifying existing FDI screening regimes. In further countries, such as the **Czech Republic**, FDI rules have been proposed and adoption is expected in the course of the year.

10. Art. 4 (1) of the EU FDI Framework Regulation refers to critical infrastructure, critical technologies, supply of critical inputs, access to sensitive information as well as freedom and pluralism of the media.

11. The Italian government provides an overview of the Italian FDI rules on its website under <http://www.governo.it/dipartimenti/dip-il-coordinamento-amministrativo/dica-att-goldenpower/9296> (Italian).

12. Real Decreto-ley 8/2020, de 17 de marzo, de medidas urgentes extraordinarias para hacer frente al impacto económico y social del COVID-19, consolidated version available in Spanish under <https://www.boe.es/buscar/act.php?id=BOE-A-2020-3824#:~:text=Real%20Decreto%2Dley%208%2F2020,Publicado%20en%3A&text=73%2C%20de%2018%2F03%2F2020>.

Key takeaways

The developments in the area of FDI review follow an ongoing trend, which we expect to continue and which might be further intensified depending on the further development of the COVID-19 crisis. All major economies now have FDI screening procedures in place and the COVID-19 crisis has intensified an already established trend in major Western economies such as the U.S., Japan, France, Germany, Spain, the UK, and others in Europe to tighten FDI. The vast number of jurisdictions enacting or tightening FDI screening mechanisms and the frequency of the related reforms in Europe and elsewhere leave no doubt that FDI regulations are an important political instrument globally and will remain so for the foreseeable future.

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. Transaction timeframes are also subject to greater uncertainty, because many FDI regimes have unclear and open-ended review timetables, for instance due to requests for information stopping the clock of the review. In addition, the need for the relevant ministry or

authority in charge of FDI screenings to coordinate with specialized government agencies can lead to prolonged screening procedures. Moreover, procedures are often purposefully opaque in order to conceal the national security interests at issue. It is therefore often unclear what substantive issues are investigated and the authority may not share its concerns for confidentiality reasons.

Concerns about investors taking advantage of the COVID-19 crisis by acquiring valuable assets of companies in financial distress are widespread in Europe and will likely result in authorities making full use of their screening powers or even expanding their existing screening powers. Even in cases where transactions have been envisaged long before the health crisis, companies may still face increased scrutiny.

For transactions in the aerospace and defense industry, parties should expect particular scrutiny given the importance from a national security perspective. A thorough review of where potential FDI filings need to be made and a coherent strategy for such filings including relevant stakeholder management is required.



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