Economic patriotism: France's regulations more bark than bite

By *Winston Maxwell*

Narrower than U.S. "Exon-Florio" rules, France's new foreign investment regulations target narrow defense-related sectors, and should prove workable for U.S. investors. But the rise of economic patriotism is worrying for the internal market.

Mention economic patriotism, and most foreign observers of France think of yoghurt. "*L'affaire Danone*" hurt France's image abroad, leading many to fear that France's new policy of economic patriotism would shield broad ranges of French companies from foreign takeover. When France's new regulations on foreign investment were actually published on December 31 of last year, investors were relieved to discover that they affected only 11 sectors, mostly defense-related. Yoghurt was not on the list.

Indeed, the French regulations [(1)] are much narrower than comparable U.S. regulations on foreign investment, the so-called Exon-Florio rules. Exon-Florio rules permit the president to veto foreign takeovers that raise a credible threat for U.S. national security. The concept of "national security" is not defined in the U.S. regulations, which gives the president and the Committee on Foreign Investment in the United States (CFIUS), the bureau that processes foreign investment filings, latitude to decide what kinds of business could be subject to presidential veto. For example, under U.S. regulations, the CFIUS could in theory decide that Tillamook cheese was critical for U.S. national security and recommend that the president block a takeover by Danone of the famous Oregon cheese-maker.

CFIUS would never do so, of course, unless it could show credible evidence of a serious national security threat. But the U.S. law itself is sufficiently flexible to allow such broad interpretations. CFIUS and the president have expanded the notion of national security in the wake of the September 11, 2001 terrorist attacks, but have been careful not to go overboard: they have blocked only one transaction out of almost 2,000 filings. CFIUS may, however, encou–rage an investor to modify a transaction or agree to special "security agreements" with the FBI as a condition to going forward.

When the U.S. regulations were enacted in 1988, American lawmakers were concerned that Japanese acquisitions of U.S. semiconductor manufacturers would undermine the United States' technological leadership, rendering the U.S. dependent on foreign suppliers for key military components. This resembles France's fear today that U.S. private equity firms are acquiring too many French technology firms, decreasing France's technological independence and ultimately her sovereignty. The recent regulations adopted in France permit the government to veto transactions in limited defense-related sectors. Some French politicians admire the breadth and flexibility of the U.S.'s Exon-Florio rules, wishing that France could do the same [(2)]. France cannot, however, because of the EC Treaty, which protects freedom of investment and movements of capital. To comply with the EC Treaty, French regulations limiting foreign investment have to be narrowly tailored to address specific industries demonstrably linked to interests of national defense or public order, as those concepts are interpreted by the European Court of Justice.

A broad-brush approach, similar to that used in the U.S., is not possible. Any restriction to investment must be "proportionate" to a clearly identified threat. That is why the French had to narrow their regulation down to 11 sectors, each with a clear link to national defense or public order. The new regulations require that any acquisition by a foreign company (EU or non-EU) of a French business active in one of the 11 identified sectors receive advance clearance from the French Ministry of Economy. The regulations allow the French ministry to negotiate security conditions, a practice that has become frequent in the United States under Exon-Florio rules. The Ministry of Economy must render its decision within two months. The 11 sectors listed in the regulation cover a hodgepodge of security-related businesses: casinos; private security services for critical infrastructure; substances used for chemical or germ warfare; wiretapping and electronic surveillance equipment or systems; certification services to guarantee IT security; computer security services for critical infrastructure; certain dual-use technology; encryption; businesses holding classified defense secrets; research, production or sale of arms; and companies with contracts to supply any of the foregoing to the Ministry of Defense.

---

(1) *Decree n° 2005-1739 of December 30, 2005.*

(2) *B. Carayon, "Economic Intelligence, competitivity and social cohesion", Report for the Prime Minister, 2003.*

The French regulations are narrow, but not narrow enough for the European Commission. Several weeks after the new regulations were issued, the Commission questioned France about their compatibility with the EC Treaty. Why, asks the Commission, would the acquisition of a casino by a foreign company create a greater threat of money-laundering than an acquisition by a French company? For the Commission, a more appropriate response would be to enact stricter regulations to prevent money-laundering by casino owners, which would apply to any company (French or foreign) operating a French casino. Foreign investments need not be singled out.

As regards investment in arms manufacturers and bio-terror vaccines, the Commission recognizes that it may be important to keep production on French territory, but asks why it would not be sufficient to enact a law requiring that production capacity remain on French soil, instead of singling out foreign investment for special treatment. The Commission generally believes that France's new foreign investment rules are not proportionate enough in dealing with the identified security risks, and instead create an unnecessary and discriminatory burden on foreign investment.

Many French strategic companies are not covered by the 11 sector list. In the case of Suez, the French government has had to develop a controversial plan to merge Suez with Gaz de France in order to protect Suez from takeover by Italy's Enel. The hostile takeover of Arcelor by Mittal is another situation where the new French regulations provide no protection. Les Aéroports de Paris would probably also fall outside the decree, even though security firms working at the airport, or firms providing computer security to the airport, would fall within the decree. The EC Treaty, and a key decision of the European Court of Justice involving the Church of Scientology [3], severely limit what the French government and the governments of other EU countries can do in terms of foreign investment. This has lead governments to try more subtle techniques. Spain's new law permitting the national energy regulator to impose conditions on any acquisition of a regulated Spanish energy company [4] has drawn fire from the European Commission as a disguised attempt to quash E.ON's takeover of Endesa.

Astutely, the Spanish parliament did not mention foreign investors in its law, referring instead to any takeover of a regulated Spanish energy company. The law on its face applies to Spanish and non-Spanish investors alike, and therefore would not appear to violate the EC Treaty. According to press reports, the European Commission takes a different

view, and is challenging the Spanish law because it violates European laws on free movement of capital. Italy, too, has taken action to protect its freeway company Autostrade from being taken over by a Spanish rival.

What is particularly remarkable about these recent actions is that the foreign investor against whom protective measures were taken was in each case a company from a neighboring European country, part of Europe's "single market." It's as if Oregon took steps to shield a local electricity company from a hostile takeover by a California utility. To American eyes, the recent French, Spanish and Italian efforts to defend their national champions against investment by neighboring European companies suggests a flaw in the internal market.

In many cases, cross-border deals are not killed by foreign investment regulations, but by political opposition. Novartis abandoned its bid for Aventis when France's prime minister suggested that France might invoke national security (bio-terror vaccines) to oppose the deal. The Chinese oil company CNOOC withdrew from its proposed takeover of UNOCAL because of political opposition in the U.S., even before the deal made it to the CFIUS for review under Exon Florio rules. Dubai Ports had to agree to divest ownership in key U.S. ports not because CFIUS identified a credible national security threat in the Dubai Ports/P&O transaction, but because political opposition in the U.S. Congress forced the government to change its position and encourage Dubai Ports to modify its proposal.

In all these examples, the national security review process was derailed by political pressure, which conveys a bad image to foreign investors, an image that foreign investment rules are irrelevant, and that the real decisions are made by politicians behind closed doors. After remarks by the then Prime Minister Jean-Pierre Raffarin in the Novartis/Aventis case, the French government went to great efforts to reassure investors that France still welcomed foreign investment. The U.S. government was similarly embarrassed in the Dubai Ports case. CNOOC said it had learned from its U.S. experience, and would henceforth invest more in lobbying. Sophisticated French and U.S. companies know the importance of lobbying, and make sure when they invest that politicians in the country where they are investing understand well in advance ho the investors are, and what their intentions are. When politicians

[3] *Case C-54/99, Church of Scientology, ECR 2000, I-01335.*

[4] *Royal Decree-Law 4/2006 of February 24, 2006.*

understand the facts, opposition to the deal may in some cases subside. Even U.S. private equity firms, often accused of evil intentions when they invest in French firms, can get good political marks when all the facts are known. A recent parliamentary report on the European defense industry [5] looked at a number of recent private equity investments in European defense firms, and concluded that in some cases, private equity investments saved local jobs, and facilitated firms' access to new U.S. markets.

Recent figures published by the *Agence Française pour les Investissements Internationaux* [6] confirm that foreign investment in France remains strong. This suggests that economic patriotism has so far not dampened foreigners' enthusiasm for French companies. The new French regulations on foreign investment, although questioned by the European Commission, are much narrower than similar U.S. rules, and should be relatively easy for investors to deal with. Of greater concern is what economic patriotism is doing to Europe's internal market. Recent actions in France, Spain and Italy to defend local champions against takeovers by other European companies lead an outside observer to conclude that Europe's internal market may be in trouble. The internal market was created to help build European champions having the size and scope to compete on the world market. Airbus is a good example, although recent management turmoil shows that building a European champion is not easy. The internal market was also created to make Europe so economically interdependent that nationalism could never again take hold, rendering war less likely. It would be a shame if economic patriotism were to weaken these principles.

*Winston Maxwell, a partner in the international law firm **Hogan & Hartson**, has been tracking cross-border investment issues for 20 years. He has focused on businesses in the telecoms as well as other leading technology industries. Operating through 23 offices worldwide, Hogan & Hartson is particularly well-known for its advice to clients in heavily regulated industries.*

---

(5) *Parliamentary Information Report n° 2202, B ; Deflesselles and J. Michel, "European Defense Industry: from mastering the subject matter to independence," 2005, pp. 33-34.*

(6) *AFII Press Release, May 10, 2006.*