Expanding the Scope of National Security-Focused Foreign Investment Reviews in Europe

Skadden

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If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

Four Times Square
New York, NY 10036
212.735.3000

skadden.com

In large part as a response to China's national industrial goals and subsequent Chinese acquisitions of U.S. and European companies that are technology leaders in key industries, the U.S. government and a number of European governments are seeking to expand the scope of their national security reviews of foreign investments. Below, we outline the most recent developments in the United Kingdom, France and the European Union.[1]

UK: Incremental Tightening of Foreign Investment Reviews

Historically, national security reviews of foreign investment into the United Kingdom have been conducted on an *ad hoc* basis, and public interest intervention notices challenging acquisitions have been issued very infrequently. Although the U.K.'s Competition and Markets Authority vets mergers and acquisitions for competition issues, the Enterprise Act of 2002 provides the U.K. government with a limited authority to intervene in transactions for national security reasons, and there is no systematic process for reviewing such notices from a national security perspective.

Largely in response to U.K. politicians' advocacy for a more cautious approach to foreign investment — especially in key technology sectors and for investments originating from China — the U.K. secretary of state for business, energy and industrial strategy published proposals to amend the Enterprise Act. These proposals resulted in two amendment orders being enacted by Parliament on May 14, 2018. The first of these created a new category of "relevant enterprises" to which the Enterprise Act would apply:

- **Dual-Use Export-Controlled Technology.** Enterprises that develop or produce export-controlled items with dual military and civilian uses, or that hold information concerning the development, production or performance characteristics of such items;
- **Computer Hardware and Software.** Enterprises that own, create or supply intellectual property relating to computers, their instruction set architecture, and their low-level control code, as well as enterprises that design, maintain or provide support for the secure provisioning of computer security hardware, software, firmware and encryption keys; and
- **Quantum Computing.** Enterprises that conduct research and development of, produce components used in or provide services employing quantum computing and its applications in simulations, imaging, sensing, timing, navigation, communications or quantum-resistant cryptography.[2]

The second amendment order substantially reduces the threshold for U.K. government review of acquisitions of relevant enterprises. Currently, the U.K. can review transactions in which either (i) the combined entity, by virtue of the acquisition, holds a market share of at least 25 percent in all or a substantial portion of the United Kingdom or (ii) the target entity has annual U.K. sales of at least £70 million. As amended, the Enterprise Act extends this jurisdiction to transactions involving the acquisition of relevant enterprises in which either (i) the target already holds a 25 percent market share in all or a substantial portion of the United Kingdom or (ii) the target has annual U.K. revenues of at least £1 million.[3]

[1] *See* our June 28, 2018, client alert, "President Trump Tentatively Looks to FIRRMA to Expand US Foreign Investment Reviews," for an update on developments in the United States.

[2] The Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018, 2018 No. 578, May 14, 2018.

[3] The Enterprise Act 2002 (Turnover Test) (Amendment) Order 2018, 2018 No. 593, May 14, 2018.

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Although these amendments show a commitment to growing the U.K. government's authority to review foreign investments for national security risks, these changes are not expected to have a major impact on businesses. The amendments came into force on June 11, 2018, and were not given retrospective effect, nor did they establish a formal system for notification and review of affected transactions.[4]

France: Broadening the Scope of Control and Reinforcing Sanctions and Remedies

On June 18, 2018, the French government presented draft legislation aiming to reform French foreign investment rules.[5] Under the current rules, prior to acquiring a company or a business in France involved in certain sensitive or strategic activities, a foreign investor (the Investor) must notify the French Ministry of Economy (the Minister) of the proposed investment and receive authorization from the Minister (the French Prior Authorization Regime). The Minister's authorization is generally conditioned on the Investor entering into certain commitments pertaining to the preservation of French sensitive activities and resources, and information vis-à-vis the French state. The purpose of the draft bill, the Action Plan for Business Growth and Transformation (the PACTE Law),[6] is to extend the scope of the French Prior Authorization Regime to certain key technologies[7] and make it more efficient by expanding applicable remedies and sanctions. The draft bill will be presented for debate before the French Parliament in the fall. Once adopted, the new law will need to be completed by decree.[8]

The PACTE Law will implement four significant changes to French foreign investment rules:

- **Extension of the Scope of the French Prior Authorization Regime.** Four years ago, the scope of French foreign investment control was extended to certain strategic sectors (energy, transports, telecommunications, critical infrastructures, water and public health) by the so-called Montebourg Decree.[9] The French government has announced that the implementing decree of the PACTE Law will further extend the French Prior Authorization Regime to semiconductors, space technology and drones, and to the extent that it relates to national security interests, artificial intelligence, cybersecurity, robotics and big-data storage.

- **Expansion of the Minister's Remedial Powers.** The PACTE Law reinforces the ability of the Minister to seek injunctive relief in order to enforce compliance with the French Prior Authorization Regime. The draft bill provides that if an Investor did not submit a covered transaction for authorization, the Minister will be entitled to enjoin the Investor to request authorization ex-post or modify or unwind the transaction at the Investor's cost. The Minister may impose daily penalties ("astreintes") on the Investor for failure to comply with any of these injunctions.

  The PACTE Law also authorizes the Minister to exercise remedial powers in the event that after completion of the investment, the Investor fails to comply with its commitments vis-a-vis the French state. If an Investor does not comply with such commitments, the Minister will be entitled to (i) withdraw the initial authorization (in which case the Investor will be required to request a new authorization), (ii) enjoin the Investor to comply with the agreed-upon commitments, or (iii) impose new binding commitments or obligations on the Investor (which may include the sale of all or a portion of the relevant French sensitive activities to a third party or the unwinding of the initial transaction). The Minister may impose daily penalties on the Investor for failure to comply with any of these injunctions.

  If an Investor fails to comply with the French Prior Authorization Regime or with its commitments vis-à-vis the French state, and if the relevant investment poses a threat to the public order, public security or national defense interests of the country, the Minister may take the following provisional measures ("mesures conservatoires"): (i) suspension of the voting rights or dividend distributions with respect to the shares held by the

[4] The U.K. Department for Business, Energy and Industrial Strategy estimated that only five to 29 additional transactions per year will be subject to review as a result of the changes. Moreover, the government expects only one to six of these transactions to raise national security concerns sufficient for the issuance of a public interest intervention notice. Department for Business, Energy and Industrial Strategy, "Enterprise Act 2002: Changes to the Turnover and Share of Supply Tests for Mergers, Draft Guidance 2018," March 15, 2018.

[5] Please see our concurrent client alert, "President Trump Looks to FIRRMA to Expand US Foreign Investment Reviews," for an update on developments in the U.S.

[6] "Le Plan d'action pour la croissance et la transformation des entreprises" (Action Plan for Business Growth and Transformation), (Ministère de l'Economie (Ministry of the Economy)) (June 2018). The draft legislation is available here.

[7] Germany and Italy made similar moves in 2017. In Germany, the German Foreign Trade Ordinance was amended on July 12, 2017, to broaden the scope of the German foreign investment control over transactions involving certain national defense-related key technologies and critical infrastructures. In Italy, Law Decree 148/2017 (converted into Law 172/2017), dated October 16, 2017, extended the scope of the so-called Golden Powers (*i.e.*, the Italian government's ability to veto completion of a relevant acquisition and impose specific conditions) to include high-tech intensive industries.

[8] The PACTE Law also contemplates amending the French legal regime of golden shares ("actions spécifiques"). The French golden share mechanism allows the French state to hold certain specific rights in French companies involved in strategic sectors (*i.e.*, veto rights on the sale of strategic assets to third parties and the acquisition of shares or equity investment by third parties; information rights with respect to the French company's strategic activities). The PACTE Law proposes to (i) extend the scope of application of the French golden share mechanism, (ii) facilitate the creation and modification of golden shares, and (iii) reinforce the rights of the French state attached thereto.

[9] Decree n° 2014-479 of 14 May, 2014 (named the "Montebourg Decree," referring to then-Minister of Economy Arnaud Montebourg).

Investor in the French company,[10] (ii) designation of an ad hoc administrator for the French company in charge of preserving national interests and (iii) restrictions on the disposal of assets used in connection with the operation of French sensitive activities.

- **Reinforcement of Financial Sanctions.** The PACTE Law grants the Minister the power to impose fines in the following four situations: (i) if an Investor fails to seek prior authorization for a covered investment, (ii) if the French authorization was fraudulently obtained, (iii) if an Investor does not comply with its commitments vis-à-vis the French state, and (iv) if an Investor fails to comply with an injunction order from the Minister.

  The fines may not exceed, whichever is higher: (i) an amount that is twice the amount of the initial investment, (ii) 10 percent of the annual revenue of the French company or (iii) €1 million for an individual and €5 million for a legal entity.

- **Notification Procedure.** Under current French foreign investment rules, an Investor may submit a request to French authorities to ascertain whether a proposed transaction falls within the scope of the French Prior Authorization Regime pursuant to the so-called "procédure de rescrit" (rescript procedure). The Minister shall answer within two months following receipt of the request. The failure by the Minister to respond within this two-month period does not amount to a tacit confirmation that the proposed investment does not fall within the French Prior Authorization Regime. The French government has announced that the implementing decree of the PACTE Law will allow French target companies to submit a similar request to French authorities as part of the rescript procedure.

Europe: EU Draft Regulation for the Screening of Foreign Direct Investments Into the EU

On September 13, 2017, the European Commission (EC) unveiled a proposal (the EU Proposal) to set up a European legal framework to screen foreign direct investments into the European Union. The EU Proposal takes a prudent approach and:

- does not contemplate the setting up of a centralized mechanism at the EU level, rather it builds on existing foreign investment controls at member states' level; and

- does not require member states to implement a screening mechanism, but instead ensures that any existing or proposed mechanism complies with a set of minimum requirements (including on the procedural front).

The EU Proposal states that in determining whether a foreign direct investment may affect security or public order, member states and the EC may consider the potential effects of such investment on, *inter alia*:

- critical infrastructure, including energy, transport, communications, data storage, space, financial infrastructures and sensitive facilities;

- critical technologies, including artificial intelligence, robotics, semiconductors, technologies with potential dual use application, cybersecurity, space and nuclear technology;

- the security of supply of critical inputs; or

- access to/or ability to control sensitive information.

The list of screening factors is, however, not exhaustive. Member states and the EC also may take into account other factors such as whether the foreign investor is controlled by the government of a third country, including through significant funding.

The EU Proposal provides for a comprehensive cooperation mechanism among member states and the EC when a foreign direct investment in one or several member states could potentially affect security or public order in other member states. The proposed cooperation mechanism contemplates the following:

- Member states are required to inform other member states and the EC of the opening of any screening procedure related to a foreign direct investment.

- Other member states and the EC are entitled to request information from the screening member state; other member states may provide comments and the EC may issue nonbinding opinions to the screening member state regarding the relevant foreign direct investment.

- The screening member state shall give due consideration to these comments and opinions, but it shall retain final decision-making power regarding the foreign direct investment.

In circumstances where a foreign direct investment is likely to affect projects or programs of Union interest,[11] the EU Proposal provides that the EC may carry out its own review on grounds of security and public order. In such cases, the EC is entitled to address an opinion to the member state where the investment will take place or has been completed. The member state has to take "utmost account" of the EC's opinion and provide an explanation to the EC if it chooses not to follow the opinion.

[10] Under the current draft bill, the suspension of voting rights or dividend distributions shall only apply to the portion of the French company's shares held by the Investor above the relevant triggering threshold under French foreign investment rules (*i.e.*, 50.1 percent of the French company's voting rights for EU Investors and 33.33 percent of the French company's shares or voting rights for non-EU Investors).

[11] These shall include, in particular, projects or programs that involve a substantial amount of EU funding or that are covered by EU legislation on critical infrastructure, technologies or inputs (*e.g.*, the Galileo satellite program).

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The EU Proposal is currently following the ordinary European legislative procedure whereby it will need to be adopted by the European Parliament and member states in the European Council. The EU Proposal may therefore evolve from its current form. On June 5, 2018, the European Parliament's Committee on International Trade adopted an amended version of the EU Proposal providing for, among other things, (i) the obligation for the EC to issue an opinion to the relevant member state when a foreign direct investment is likely to affect projects or programs of Union interest on grounds of security or public order, and (ii) the possibility for one-third of member states to force dialogue with the member state where the foreign direct investment is planned or has been completed if these member states consider that such investment is likely to affect their security or public order. On June 13, 2018, the EU ambassadors agreed on the European Council's position, paving the way for three-way discussions with the European Parliament and the EC in order to reach a final compromise.

Contacts

Pascal Bine
Partner / Paris
33.1.55.27.11.01
pascal.bine@skadden.com

Sandro de Bernardini
Partner / London
44.20.7519.7108
sandro.debernardini@skadden.com

Matthias Horbach
Partner / Frankfurt
49.69.74220.118
matthias.horbach@skadden.com

Michael E. Leiter
Partner / Washington, D.C.
202.371.7540
michael.leiter@skadden.com

Ivan A. Schlager
Partner / Washington, D.C.
202.371.7810
ivan.schlager@skadden.com

Donald L. Vieira
Partner / Washington, D.C.
202.371.7124
donald.vieira@skadden.com

Jonathan M. Gafni
Counsel / Washington, D.C.
202.371.7273
jonathan.gafni@skadden.com