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# Foreign Investment Control Reforms in Europe


Contributing Partners

**John Adebiyi** / London

**Pascal Bine** / Paris

**Matthias Horbach** / Frankfurt

**Dmitri V. Kovalenko** / Moscow

Associates

**Jason Hewitt** / London

**Mikhail Koulikov** / Moscow


The geopolitical environment continues to drive reform of foreign investment rules in Europe, with government proposals clarifying and tightening such rules in the interest of national security. Recent foreign state-backed investments in critical European Union infrastructure, in particular, have sparked concerns that the EU's collective security is jeopardized by the lack of a harmonized foreign investment control framework.

The current focus on foreign investment in Europe mirrors developments across the world, including recent CFIUS reform. (See our August 6, 2018, client alert "US Finalizes CFIUS Reform: What It Means for Dealmakers and Foreign Investment.") With incoming EU and U.K. regimes, as well as recent developments in France, Germany and Russia, long-standing CFIUS experience in the U.S. has the potential to be a useful gauge for future developments (for example, the jurisdiction expansion to noncontrolling investments).

The new CFIUS reforms instruct the CFIUS chairperson to establish a formal process for information sharing with allies and other U.S. partners, which may lead to cross-jurisdictional engagement by regulators becoming a more prominent feature of global transactions (even where reviews are not triggered).

Foreign investors doing business in Europe — particularly those from countries that might be deemed a risk — should be mindful of the changing landscape. Specifically, governments have expanded or are looking to expand the industries deemed critical to national security, reduced the level of investment required to trigger a review, or created new methods of review and/or enforcement for national security issues. However, the increased tightening of controls and scrutiny of the underlying motives of state-backed investors has the potential to free up investment opportunities for those investors in countries less likely to be deemed a risk.

Insight into the more mature CFIUS process provides a valuable road map for investors in approaching European regulators and overall transaction management, such as advance planning to ensure foreign investment and national security issues are assessed early in a deal's life cycle.

## European Union

The European Parliament, Council and Commission reached an agreement in November 2018 on an EU legal framework for screening foreign direct investments into the EU, which will apply to investments by non-EU investors. The centralized framework was formally unveiled in the EU during President Jean-Claude Juncker's September 2017 State of the Union address, which placed particular emphasis on foreign state-backed acquisitions of European infrastructure and technology. The framework reportedly now has sufficient support among member states, and the European Parliament is expected to vote on it in the first quarter of 2019.

The framework focuses on investments that affect the EU's collective security, as highlighted by Juncker's remarks: "If a foreign, state-owned, company wants to purchase a European harbour, part of our energy infrastructure or a defence technology firm, this should only happen in transparency, with scrutiny and debate. It is a political responsibility to know what is going on in our own backyard so that we can protect our collective security if needed."




Four Times Square
New York, NY 10036
212.735.3000

Key sectors that will be subject to the framework are: critical infrastructure, critical technologies (*e.g.*, artificial intelligence (AI), robotics, semiconductors, dual-use, cybersecurity, space, nuclear), critical inputs, sensitive information, media, land and real estate, water supply infrastructure, data processing and electoral infrastructure. The EU proposal also identifies control of a foreign investor by the government of a country outside the EU, including through significant funding, as a potentially sensitive factor.

The framework stops short of creating a centralized review (*i.e.*, approval/rejection) mechanism but does provide for closer cooperation and coordination among member states. The screening member state must notify other member states and the European Commission of any foreign investment under its review. Other member states and the European Commission may issue nonbinding opinions to the screening member state if they believe the relevant foreign investment may affect EU security or public order. The European Commission also may carry out its own review of foreign investments that are likely to affect projects or programs of EU interest. Member states retain final decision-making power regarding foreign investments in their respective territories. In light of this type of coordination, investors should consider national security implications across all relevant EU member states, not just the primary jurisdiction of a target.

Given the current uncertainty relating to Brexit — particularly after the U.K. Parliament rejected the draft withdrawal agreement on January 15, 2019 — it is not clear how the proposed EU legal framework will apply to the U.K. The draft agreement generally provided for the U.K. to continue to be treated as an EU member state (aside from rights to participate in EU institutions) until the end of the agreed transition period. If an agreement is not ultimately approved, the U.K. will lose its member state status on March 29, 2019.

Some EU member state screening regimes treat EU/European Economic Area (EEA) investors differently than they do non-EU/EEA investors (for example, Germany, where investments by EU/EEA investors are generally not reviewable, except in specific sectors such as defense and information technology (IT) security for government classified information). Accordingly, Brexit may result in the U.K. being subject to different foreign investment rules in relevant EU jurisdictions beginning in March 2019.

## France

In June 2018, the French government introduced a proposal to reform its foreign investment rules as part of the PACTE Law (Action Plan for Business Growth and Transformation). The purpose of the reform is to strengthen French foreign investment control and make the French clearance process more efficient vis-à-vis foreign investors. The PACTE Law was amended and adopted by the National Assembly in October 2018 but still requires Senate approval. The bill is expected to be passed in the first half of this year.

Covered investments under French foreign investment law currently require prior authorization by the French minister of the economy. This authorization is generally conditioned upon the foreign investor entering into certain commitments pertaining to the preservation of activities, resources and information that are sensitive from a French national defense or security standpoint. The ongoing reform would give the French authorities clearer and broader remedial powers to enforce compliance with the prior authorization requirement and foreign investors' national security commitments:

- If an investor does not submit a covered investment for authorization, the French authorities would be entitled to enjoin the investor to request authorization ex post or modify or unwind the transaction at the investor's expense.
- If, after completion of the investment, the investor fails to comply with its national security commitments, the French authorities could, among other actions, withdraw the initial authorization (in which case the investor will be required to request a new authorization or unwind the transaction) and impose new binding obligations on the investor, including the sale of sensitive French assets to a third party.
- In certain circumstances, the French authorities also would be entitled to (1) suspend voting rights and dividend distributions with respect to a portion of the French company's shares held by the investor, (2) appoint a special trustee in charge of preserving national interests at the French company level, and (3) restrict the investor's ability to dispose of sensitive French assets.
- The PACTE Law also would allow the French authorities to apply more effective financial sanctions against a foreign investor in the following four situations: (1) if an investor fails to seek prior authorization for a covered investment, (2) if the French authorization is fraudulently obtained, (3) if an investor does not comply with its commitments vis-à-vis the French state, and (4) if an investor fails to comply with an injunction order from the French minister of the economy.

Additionally, the PACTE Law reform would increase transparency by requiring the French government to publish annual statistics on the control of foreign investments in France and establishing a parliamentary delegation on economic security matters in charge of monitoring the French government's actions in this area.

Pursuant to a decree dated November 29, 2018, the scope of French foreign investment control has been expanded to cover the following activities: space operations, storage of sensitive data, operation of electronic and IT systems required for public security purposes, and activities relating to equipment for capturing computer data, as well as research and development activities in the following sectors: semiconductors, AI, cybersecurity, robotics, additive manufacturing, and dual-use goods and technologies. The new scope became effective on January 1, 2019.

Lastly, the November 29, 2018, decree allows a French target company to submit a request to the French authorities to ascertain whether a proposed transaction falls within the scope of the French prior authorization regime. (That option was previously open only to foreign investors.) The decree also extends the scope of reasons the French authorities may validly consider in order to block a proposed foreign investment.

## Germany

Effective December 29, 2018, the German government reduced the review threshold for foreign investments in companies in certain industries to 10 percent of the company's voting rights. The previous threshold of 25 percent remains applicable for investments in companies outside those industries. Minority investors that have been exempt from foreign investment review in the past will have to consider the new threshold, which applies to industries deemed of particular interest for national security reasons, including defense and IT security for government classified information as well as critical infrastructure (*e.g.*, energy, telecommunications, transport and traffic, health, water and food suppliers, finance and insurance). The new rules now also list as critical infrastructure media enterprises that contribute to the formation of public opinion.

The updated German Foreign Trade and Payments Ordinance ("Außenwirtschaftsverordnung") comes at a time of intense public discussion over security concerns and the protection of technology, resulting from high volumes of investments from China as well as supply chain and, more generally, trade policy considerations. Significant foreign investments in key technologies have spurred concerns that the security and infrastructure of the country as well as the supply of German industry might become dependent upon investors from non-EU/EEA jurisdictions. Elements of trade policy are evident in recent initiatives by the Federal Ministry for Economic Affairs and Energy to promote the production of battery cells for electric vehicles in Germany and to support companies active in the development of artificial intelligence. In this context, the ministry has even suggested that the government create a state fund that could intervene and purchase entities that undesirable investors may be seeking to acquire. While at this time the suggestion is not being implemented, it appears realistic that the idea of a state fund will be further pursued in the long term.

In addition to the ordinance update, the ministry has significantly intensified its reviews of foreign investments, resulting in proceedings taking significantly longer than in the past — often between six and 12 months, compared to one to two months previously. It also has taken more actions to intervene on possible foreign investments than it typically had.

When State Grid Corporation of China considered a 20 percent investment into the German electricity network operator 50Hertz Transmission GmbH in mid-2018, the German government found it could not rely on the foreign investment regime to intervene, given the 25 percent threshold requirement. However, it considered the Chinese entity's interest a concern for national security reasons and reviewed other channels to stop the investment. Ultimately, German government-owned development bank KfW entered into an arrangement with the majority shareholder of 50Hertz, Belgian corporation Elia System Operator. Under that arrangement, Elia exercised its right of first refusal of the 20 percent stake in 50Hertz that had been offered to State Grid Corporation and sold that interest to KfW on the same terms. This move serves as an example of the German government's increased desire to become involved and was one of the trigger points for the initiative to reduce the review threshold for critical infrastructure to 10 percent.

## Russia

In June 2018, the Russian parliament adopted a number of significant amendments to the Russian Strategic Enterprises Law and Russian Foreign Investments Law.

### Russian Strategic Enterprises Law

Effective June 12, 2018, the concept of offshore investors has been removed from the Russian Strategic Enterprises Law. This concept was added under amendments made in July 2017, which extended the rules restricting the acquisition of certain interests in Russian strategic enterprises by a foreign state or international organization (or persons controlled by them) to any investor incorporated in an offshore jurisdiction or controlled through an offshore entity.

The rules that previously applied to offshore investors will now apply to foreign legal entities and foreign unincorporated organizations (foreign investors) that do not disclose to the Federal Antimonopoly Service of Russia their controlling persons, beneficiaries (those individuals for whose benefit the foreign investor acts) and beneficial owners (those individuals who, directly or indirectly, have an interest of more than 25 percent in the foreign investor or have the ability to control the foreign investor's decisions). The procedure for disclosure also was detailed in the amendments.

Under the rules, an acquisition by a foreign investor of control of a Russian strategic enterprise (generally, more than 50 percent of the voting rights of a Russian strategic enterprise, or 25 percent or more in the case of a subsoil user) requires the prior approval of the Russian government following a disclosure and is prohibited without such disclosure. An acquisition by a foreign investor of more than 25 percent of the voting rights of a Russian strategic enterprise (or more than 5 percent in the case of a subsoil user) but less than control is permitted without prior approval so long as the foreign investor makes the appropriate disclosure; if the foreign investor does not make the disclosure, the prior approval by the Russian government is required.

### Russian Foreign Investments Law

In July 2017, the Russian Foreign Investments Law was amended to permit the Russian government to review any transaction entered into by a foreign investor with respect to any Russian legal entity if necessary for ensuring national defense and state security. At that time, the term "foreign investor" for the purposes of the Russian government's review of such transactions was expressly extended to apply to Russian nationals with dual citizenship and organizations — including those incorporated in Russia — that are controlled by foreign investors.

While such a review regime is still applicable to this category of foreign investors in accordance with the procedure set out in the Russian Strategic Enterprises Law, starting on June 12, 2018, the following persons are no longer considered foreign investors for the purposes of the guarantees and protections provided under the Russian Foreign Investments Law:

- a foreign legal entity controlled by a Russian citizen and/or by a Russian legal entity;
- a foreign unincorporated organization controlled by a Russian citizen and/or by a Russian legal entity; and
- a foreign citizen who also has Russian citizenship.

Notably, the term "foreign investment" has changed to include only those investments made by a foreign investor "directly and on its own." It appears that this amendment has been designed to make the guarantees and protections provided under the law inapplicable to those investors who fall into any of the categories listed above.

### United Kingdom

In July 2018, the U.K. government published a white paper in which it proposed changes to the national security screening regime for public consultation. The proposals represent a significant expansion of the government's powers to intervene in transactions on national security grounds and, if enacted, could bring about material changes to the management of transactions in what has historically been one of the world's most liberal and open economies from the perspective of inward investment.

Of course, given the importance of foreign direct investment to the U.K. economy (the white paper notes that on average, between 2007 and 2017 the U.K. ranked third among G-20 nations for flows of inward foreign direct investment) and the current uncertainties as to the impact of Brexit on the U.K. economy, these new proposals come at a particularly sensitive time. The U.K. government has emphasized that it understands the importance of foreign investment to the U.K. but believes that the reforms are needed to address the challenging and changing national security threats it faces. The white paper notes that the challenges raised by the activities of hostile states, technological advances and developments in the global economy have led to other advanced economies, such as Germany, Japan and Australia, also reforming their approaches to the review of foreign investments, and that the government's proposals are consistent with this global trend. A number of responses to the government's consultation have stressed the need for clarity and proportionality in the final legislation and its application so as to avoid any chilling effect on investment in the U.K.

The white paper proposes a regime whereby parties to a transaction would notify the government if certain "trigger events" (such as the acquisition of more than 25 percent of the votes or shares in an entity, the acquisition of "significant influence or control" over an entity or the acquisition of more than 50 percent of, or significant influence or control over, an asset) raise any national security concerns. Under the proposed regime, the government would have the power to clear notified transactions, require compliance with certain conditions or block transactions entirely. If the parties do not voluntarily notify the government, but a transaction is subsequently identified as raising national security issues, the government would be able to review the transaction for up to six months after it takes place. If necessary, it could take remedial action, including requiring the transaction to be unwound.

The focus of the proposed regime is on certain core areas of the economy, including national infrastructure (civil nuclear, communications, defense, energy, transport), certain advanced technologies, critical direct suppliers to government and emergency services, and military or dual-use technologies. However, the white paper makes it clear that the potential scope of the proposal is much wider and would extend to any proposed investments in areas of the economy where the government deems it necessary to intervene to protect national security.

The U.K. government is expected to report on its findings following its review of public responses in early 2019. Investors should watch this space carefully. If the proposed regime is introduced, many of the techniques used successfully in other jurisdictions with long-standing national security review regimes of a similar nature such as the U.S. — particularly with respect to due diligence and transaction planning and structuring — could be applied in the U.K. to a much greater extent than before.

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