Skadden

UK Follows Global Trend To Enhance National Security Protections

Contributing Partner

Bruce Embley / London

One of the biggest M&A developments over recent years has been a significant enhancing of foreign direct investment (FDI) and national security protections by G-8 members and others.

The U.S. regulatory body CFIUS (Committee on Foreign Investment in the United States) is regarded by many nations as setting the standard on how to regulate FDI. The expansion of CFIUS' powers following a new U.S. law in 2018 (the Foreign Investment Risk Review Modernization Act, or FIRRMA) has had a significant impact on cross-border M&A activity. As a result, increased focus on enhancing powers to screen and restrict M&A that raise national security concerns has since been seen in multiple jurisdictions, including:

- the European Union, with a new screening mechanism for FDI that became fully operational in October 2020;
- Germany, with a new FDI act that also took effect in October;
- Australia, with a proposed new law announced in June 2020; and
- the U.K., with a new law going through Parliament that is expected to be passed this year and would have retroactive effect from November 12, 2020.

These new regimes share some common themes, including a significant broadening of scope and a lowering, or outright removal, of monetary thresholds for review and intervention. As regulation of FDI has increased, cross-border M&A has, as a percentage of global M&A, conversely decreased. In 2019, only 30% of global M&A by value was cross-border in nature, according to Refinitiv data, with domestic M&A dominating. This was the lowest level of cross-border M&A in over a decade. If cross-border M&A is to recover, investors will have to learn to successfully navigate the new FDI terrain.

New UK Regime

The U.K.'s new regime establishes its version of CFIUS, called the Office for Investment (OFI). Previously, U.K. national security review had been carried out under the auspices of the national merger control review process, under the direction of government input. The creation of a dedicated unit is expected to lead to a significant change in approach. To put this into perspective, over almost the past two decades, there have been only 12 national security interventions in respect of U.K. M&A deals — although a third of these have occurred in the last couple of years. Going forward, according to the U.K. government, its newly formed OFI is expected to review up to 1,800 deals a year. The increased number of reviews and the significant broadening of the regime's scope (including the loosest possible U.K. nexus — where an international business servicing a single U.K.-based customer could be caught) will surely lead to a rise in interventions.

The new law also identifies sectors that require mandatory clearance. Consultation has recently taken place with industries to ascertain whether the current list of 17 sectors is appropriate — and the market is awaiting the outcome of that consultation. These sectors currently include advanced robotics and materials, artificial intelligence, communications, defense (including dual-use military), data infrastructure, energy, quantum technologies, space and transport. Many commentators have noted that the breadth of businesses intended to be covered, without a number of the typical safe harbors, is greater in scope than any other FDI regime of a major economy, including the U.S.

This article is from Skadden's ***2021 Insights***.

One Manhattan West
New York, NY 10001
212.735.3000

In addition, a side effect of this new regime is that parties to deals that fall outside the mandatory clearance regime and have only a tangential U.K. national security risk element might feel the need to nonetheless obtain clearance, if only to err on the side of caution. This is because the relevant secretary of state has broad powers to retrospectively unwind deals that he/she believes required, but didn't obtain, clearance. As such, the number of clearances sought — whether under the broad mandatory regime or on a voluntary basis — is expected to be significant. Obtaining clearance could be a lengthy process. The formal timeline can be up to four or five months, although the law allows the regulator to take even longer to make a decision.

Chinese investment has been a primary impetus for the changes in the U.K., as it has been in many other nations. Two of the four most recent M&A deals that have triggered intervention over the last couple of years under the previous regime involved Chinese-owned buyers, while the other two involved well-known U.S.- and Canada-based financial sponsors. A salutary warning that even though the focus of any new law may be narrowly identified, its ultimate application is likely to be broader.

Over the last couple of decades, one of the G-8 countries with the broadest FDI regimes has been France. Fifteen years later, the M&A world still remembers "strategic yogurt," which became a phrase to describe the mobilization of the French establishment to repel a rumored bid by Pepsi for Danone (in the words of its then-prime minister), "[to] defend the interests of France." With a number of new FDI regimes in G-8 countries and beyond, it remains to be seen whether we will see similar creative use of fresh legislative powers to repel unwelcome M&A, even when the potential threat to national security appears slight.