Protection not rejection: France treads fine line on FDI in strategic, sensitive industries


In May, the French Treasury released its report on foreign direct investments for the previous year, and shed light on its priorities and areas of concern. Wesley Lainé and Pascal Bine take stock of the report's findings.

On 9 May 2023, the French Ministry of the Economy's ('MoE') General Treasury Department ('French Treasury') released its annual report on foreign direct investments ('FDI') in France that the French Treasury reviewed during calendar year 2022.[1] The report provides information on foreign investments reviewed by the French Treasury pursuant to French FDI rules, which established a legal framework for the review of covered transactions in France.[2]

A key focus of the information contained in the report relates to the protection of sensitive activities, particularly national defence-related activities, which appear to trigger enhanced scrutiny

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during the FDI review process. Considering that the current geopolitical landscape is intensely focused on economic security issues, this scrutiny perhaps reflects a judgement that foreign acquisitions of French companies involved in sensitive or strategic activities should be carefully vetted to address any risk to French national security presented by such investments.

One such transaction that has garnered attention of French authorities in 2023 is the proposed acquisition of Quebec-based Velan by the US company Flowserve. Velan also owns the French company, Segault, a nuclear submarine parts supplier. The French government appears to lean in favour of blocking the acquisition of Segault as part of the transaction on grounds of national defence pursuant to French FDI rules.[3]

The report also includes practical considerations regarding the French FDI review process, and notably confirms that an interim rule that has been in effect for two years now, which lowered the threshold that triggers a foreign investment review to 10% of voting rights for certain investments, will be made permanent.

As discussed in more detail below, in addition to providing key information on the FDI review process, the report shows:

- The MoE reviewed 325 transactions in 2022, including ruling requests. The report confirms that the number of transactions submitted remained relatively constant with filings in 2021 (328).
  - The MoE authorised 131 transactions, which were assessed to be within the scope of French FDI rules.
  - The MoE imposed mitigation measures, typically in the form of binding commitments, in 53% of the transactions it authorised (70 out of 131), which is relatively the same proportion as in 2021 (54%).
  - Foreign investors from outside the European Union and European Economic Area ('EEA') were involved in most (65.8%) of the transactions reviewed by the MoE.
- Most of the covered transactions reviewed by

the MoE related to civilian (i.e., non-defence) business activities.
- Review of covered transactions in defence-related activities, however, remains a top priority for the MoE, which issued conditional authorisations in 76% of such cases.

THE MINISTRY OF THE ECONOMY'S POSITION IS NOT NECESSARILY TO REJECT SUCH TRANSACTIONS, BUT RATHER TO PROTECT NATIONAL INTERESTS BY ISSUING CONDITIONAL AUTHORISATIONS.

Number of foreign investment reviews remain steady

France attracted the highest number of investments (1,259 projects) in Europe in 2022 and FDI projects in France edged up 3% from 2021.[4] According to the report, however, filings slightly decreased from 328 in 2021 to 325 in 2022. Despite the minor divergence between the increase in the number of foreign investments and a slight decrease in filings in 2022, the number of foreign investment reviews from 2021 to 2022 remained relatively steady.

The MoE also reviewed 42 ruling requests in 2022 as part of the French FDI regime's ruling request mechanism, which provides that a French company, or foreign investor acting in agreement with such a company, may submit a request to the Minister for the Economy for a written opinion on whether the company's business activities fall within the scope of covered activities under French FDI rules.[5] Per the report, the MoE adjudged that 81% of such requests in 2022 pertained to business activities that were outside of the scope of French FDI rules.

From a practical standpoint, a ruling request is an option that should be used for transactions that fall in the grey area of the spectrum with respect to covered activities. French FDI rules include a list of business activities falling within the scope of French foreign investment control. In short, covered activities subject to control include three different types of business activities:

1. activities that are in-scope by their nature (e.g., public order, public security and national defence activities);
2. activities that are determined to be in-scope pursuant to a sensitivity test based on various criteria depending on the specificities of the relevant activities (e.g., the target's customers; the nature, specificity and use of the target's products, services and solutions; market substitutability; dangerousness of target's activities); and
3. research and development ('R&D') activities involving critical technology or dual-use goods and technology that may be used in connection with any of the activities referred to in items (1) or (2).

The French FDI guidelines published by the French Treasury highly recommend that – in the case of any doubt as to the sensitivity of the relevant target activity – the foreign investor submit a request for prior authorisation or a ruling request.[6]

Conditional authorisations imposed on most defence-related investments

According to the report, most of the foreign investments that the MoE reviewed in 2022 related to infrastructure, goods, and services pertaining to the civilian domain (i.e., non-defence related). Such activities involved sectors such as, among others, energy, water, transportation networks or public health, as well as R&D activities in the aforementioned sectors or related to critical technology. The report states that these civilian activities made up 51.9% of the investments authorised in 2022 by the MoE, which is a slight decrease from 56.9% in 2021.

The report also provides that the MoE particularly focused on defence-related foreign investments in 2022. Specifically, 42% of the filings reviewed by the MoE were assessed to be sensitive from a defence standpoint or were deemed to be dual-purpose activities (i.e., civilian and defence).[7] Notably, the MoE's enhanced scrutiny of defence-related transactions resulted in conditional authorisations being issued on grounds of defence considerations in 76% of such investments in 2022.

The report also states, however, that authorisations related to pure defence-related business activities almost doubled in 2022 to 23.7%, from 13.7% in 2021. This information is an indication that the MoE's position is not necessarily to block such transactions, but rather to protect French national interests by issuing conditional authorisations. The report states that the MoE aims to protect French national defence interests, without necessarily discouraging foreign investments that are useful for the French defence-industrial ecosystem.

The report also highlights that for such investments involving national defence sectors or activities, the French government defence procurement and technology agency participates in their review and is also involved in discussions relating to conditions that may be required as part of the clearance. Conditional authorisations appear to achieve the twin aims of protecting French national interests and preserving the longstanding French open investment policy.[8]

According to the report, France is also an active participant in the cooperation mechanism under the EU FDI Regulation.[9] In 2021, the European Commission analysed more than 400 foreign direct investments into the EU to ensure that no such investment threatens EU countries' security or public order.[10]

Tightened control of sensitive activities and technology

For the second time in three years, it appears that the French authorities will use their veto power to block a defence-related transaction. In 2020, the French authorities vetoed the proposed acquisition of Photonis, a leading French optronic technologies firm, by the US group Teledyne. Photonis, a strategic supplier to the French armed forces, was eventually sold to a French private equity firm, HLD.[11]

The US company, Flowserve, is in the process of acquiring Velan, a Canadian industrial valve manufacturing company based in Quebec. As part of the transaction, Flowserve would also acquire Velan's French businesses, Segault and Velan Lyon. Segault is a nuclear submarine parts supplier that provides components for nuclear-propelled submarines built by state-owned shipbuilder Naval Group and it also makes industrial valves that are used on France's Charles de Gaulle aircraft carrier.[12] Segault's products involve both military and civilian applications.

The French Minister for the Armed Forces, Sebastien Lecornu, has stated that he intends to oppose the acquisition of Segault as part of the transaction in order to maintain French operational control on the company. Under French FDI rules, however, the French Minister for the Economy makes the final ruling.

Observers have also publicly raised concerns about Velan Lyon being acquired as part of the transaction. Velan Lyon's operations include designing, manufacturing, selling and servicing nuclear classified valves.

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The Flowserve/Velan transaction has shown that in an era of multinational companies and globalised supply chains, M&A transactions that cross multiple borders and fall within the scope of FDI control could present complex regulatory considerations that should be assessed early on. This is particularly true when such transactions involve sensitive activities or strategic sectors.

Interim rule will become permanent

Under French FDI rules, covered investments are defined as:

1. the acquisition of control over a French company;[13]
2. the acquisition, in whole or in part, of a branch of business of a French company; and
3. for non-EU, non-EEA foreign investors only, the acquisition of more than 25% of voting rights in a French company (the Threshold Test).

In 2020, amid the Covid-19 pandemic, an interim rule lowered the 25% threshold that triggers foreign investment review to 10% of voting rights if the French company is involved in a covered activity and its shares are admitted to trading on a regulated market. The interim rule applies to investments by foreign investors from outside the EU/EEA in certain French publicly listed corporations.

On 5 January 2023, the Minister for the Economy stated that the interim rule would become a permanent rule. The report has confirmed that the details of the permanent rule will be issued this year.

Key takeaways

France has remained an important destination in Europe for investments by leading global companies. The report provides transparency for foreign investors and their advisors on the general approach of the MoE with respect to FDI control.

The French FDI regime has evolved over the years to play an essential role in protecting French national interests. The information in the French FDI annual report and recent actions by the MoE support that, going forward, sensitive and strategic activities will be one of the MoE's primary focuses for FDI control. This approach is in line with the current geopolitical landscape as countries seek to address economic security challenges. The French authorities' approach, however, does not appear to be oriented toward prohibiting transactions, but rather to strike a balance between an open economy and the defence of French national interests. The favoured method to achieve this objective appears to be to mitigate risk by issuing conditional authorisations.

The French FDI regime can be assessed to be clear, stable and transparent. The risk analysis regarding a transaction, however, is typically unique to the specifics of such a transaction. Moreover, the risk presented by a transaction may not be apparent to the parties, or even initially to the French authorities, until the MoE completes a full analysis of the transaction. Investors should work with their advisors to understand these risks early in the M&A process and proactively address such risk. Importantly, for such transactions that are likely to be deemed sensitive, anticipating and effectively negotiating the conditions for their clearance is critical for a positive outcome for all stakeholders.

Investors should also be aware that enhanced coordination between EU Member States is likely to capture more transactions involving covered activities for a close examination of such investments. Therefore, investors that are considering acquisitions involving multi-jurisdictional EU touchpoints, including France, should take such factors into consideration when assessing the FDI approvals that may be required to close the transaction.

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LINKS AND NOTES

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7. The report states that such 'mixed' investments (defence or dual-use) represented 24.4% of investments reviewed by the MoE in 2022.
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