Does Your Company's Reorganization or Spin-Off Require FDI Approval?

*Contributed by **Brooks E. Allen**, **Nicholas J. Colombo**, **Jason Hewitt** and **James E. Perry**, Skadden, Arps, Slate, Meagher & Flom LLP*

April 2024

Practitioners could be forgiven for assuming that an internal reorganization or pro rata **spin-off**—where generally a company's existing stockholders receive equity in a subsidiary of a company they already own—would not trigger obligations under a country's national security/foreign direct investment laws (which for ease we collectively refer to as FDI laws in this article). After all, where the owners of a company would be exactly the same before as after the transaction, how could any concern as to national security or investment by foreign nationals be raised?

Notwithstanding the potential wisdom behind that analysis, it is not the case under the FDI laws of a number of countries. As practitioners who frequently counsel multinational companies are aware, the number of FDI regimes across the globe has grown substantially in the last decade, resulting in an international filing and approval process in many business combinations involving multinational companies that may rival the breadth and complexity of the competition approval workstream.

As countries have rushed to enact **FDI regimes**, the laws are often drafted extremely broadly, and as new regulatory bodies are inaugurated to enforce these laws, they often lack a substantial history of decisions or practices that practitioners can rely on informally. As a result, a growing number of countries, either expressly or implicitly by the breadth of the language in their governing statutes and rules, view a reorganization or spin-off as triggering a filing obligation and potentially prior approval from a regulator—or expiration of a waiting period.

Failure to make the required filings and obtain the proper approvals could subject a company to fines, the invalidation of certain transactions related to the spin-off or even criminal liability. Further, ignoring local requirements, even if done by accident, could create difficulty in dealing with regulators in future strategic transactions where approval is required.

Below we provide some examples of how the FDI regimes in some key jurisdictions treat reorganizations or spin-offs. It should be noted that a determination of whether the FDI laws in these jurisdictions would apply to a specific transaction is highly fact dependent. Companies should consult counsel for guidance in this regard.

US

In general, the **Committee on Foreign Investment in the United States (CFIUS)** has jurisdiction to review "covered control transactions," meaning transactions that could result in foreign control of a US business. CFIUS may also review certain non-controlling investments in sensitive businesses. Mandatory filing may be triggered in certain circumstances, for instance in certain transactions involving US businesses that produce, design, test, manufacture, fabricate or develop technologies subject to US export controls.

CFIUS jurisdiction is quite broad such that an internal reorganization or spin-off may be considered a covered control transaction. In particular, the introduction of a new foreign entity within the ownership as part of a reorganization or spin-off may result in foreign persons obtaining control over a US business. This is possible, for instance, in restructurings of multinational businesses where US subsidiaries are reorganized under new or existing non-US entities. In some but not all cases, a reorganization or spin-off may also result in mandatory CFIUS filings. For example, a mandatory filing may be triggered when a US subsidiary reorganized under certain foreign entities also produces, develops or manufactures export-controlled technologies.

France

The French FDI regime requires prior authorization when a foreign investor makes a "covered investment" in a French entity or commercial establishment registered in France (each, a French business) involved in a sensitive activity covered by the regime in France (a covered activity). As a general matter, where a French business is involved in a covered activity, no filing under the French FDI regime would be required so long as the ultimate controlling shareholder of the French business does not change following a reorganization or spin-off.

This exemption does not apply, however, if the reorganization or spin-off:

- Has the effect of preventing a foreign investor from complying with commitments imposed as part of a prior French FDI clearance;
- Involves transferring abroad, wholly or partially, a branch of the French business; or
- Involves transferring a sensitive French business from one investment fund vehicle to another vehicle, even when both are managed by the same management company.

In the case of transfers among fund vehicles in a single investment group, the French FDI authorities will assess the transaction on a case-by-case basis to determine whether the transfer may be exempt.

Germany

Reorganizations and spin-offs are generally exempt from review under the **German FDI regime** where the acquisition of a German company is solely concluded “between companies whose respective shares are held in full by the same controlling company, and all contracting parties have their headquarters located in the same third country.” The German FDI regime therefore would not apply to a reorganization or spin-off where the foreign seller and the purchaser of a German company were both headquartered in Japan and both entities were owned and controlled by the same Japanese entity.

Under the letter of the law, however, a similar transaction involving a Dutch seller and a Japanese purchaser, even where both companies are owned and controlled by the same Japanese entity, would not appear to be exempt. The German FDI regulator has clarified in guidance, however, that internal reorganizations are exempt from German FDI review if “the controlling company stays the same, changes are limited to the investment and no shareholders from a previously uninvolved jurisdiction come in.” Therefore, reorganizations or spin-offs in the second example would generally be exempt under the Germany FDI regime as well.

Japan

The **Japanese FDI regime** (FEFTA) may apply to a reorganization or spin-off, even without any change in control at the ultimate parent's level. Filing requirements under the FEFTA are generally triggered by direct transfers of shares, businesses or assets of a Japanese entity.

Depending on the details, the FEFTA may apply to a reorganization or spin-off involving a direct transfer of shares, business or assets of one or more Japanese subsidiaries. Once triggered, prior notification is required under the FEFTA and approval must be received prior to the consummation of each direct transfer if the relevant Japanese subsidiaries are engaged in specified business sectors that relate to protection of national security, maintenance of public order or safeguard of public safety.

Although it is rare that the Japanese FDI authorities would stop a proposed reorganization or spin-off, in examining a prior notification, the authorities typically ask detailed questions about the transaction, including regarding the:

- Current and post-closing ownership structure,
- Entity acquiring the Japanese subsidiary's shares or businesses or assets,
- Japanese subsidiary's business activities and relevant technologies,
- Post-closing management plan, and
- Purpose of the group reorganization or spin-off.

UK

In the **UK**, the National Security and Investment Act 2021 (NSIA) applies to both reorganizations or spin-offs which involve a change in ownership or control—directly or indirectly—exceeding relevant thresholds of any entity carrying on activities in the UK in one of several sensitive sectors. This includes reorganizations involving direct or indirect transfers of ownership or control where the ultimate parent company remains the same and all entities continue to be wholly owned.

Similarly, spin-offs also fall within the NSIA regime where the relevant thresholds are exceeded, for example by interposition of a new top holding company (SpinCo) or where recipient shareholders' or new sponsor investors' interests exceed relevant thresholds. Given that a reorganization usually precedes any spin-off, both aspects of the transaction are often handled in a single filing, where required. The inclusion of reorganizations within the NSIA is a topic much discussed in the UK, and the UK Government's recent call for evidence sought views on how and whether the regime should continue to apply to intra-group reorganizations.

How to Be Prepared

Companies and practitioners can take the following steps to be prepared for the possibility of one or more FDI filings in the context of a reorganization or spin-off. Companies should:

- Identify early on in the planning process the specific countries in which a company operates, including where the company has subsidiaries, branches, revenues and employees.

- Assess whether, and where, the company is engaged in business activities that may be sensitive from a national security or public safety perspective. Such activities may include the production or sale of dual use or military items, manufacturing, research and development in sensitive sectors, the support or provision of public infrastructure or cyber-security, or the handling of sensitive personal data.

- Determine whether the contemplated reorganization or spin-off involves complicating elements, such as a parallel third-party investment (i.e., a "sponsored" spin-off), that may need to be taken into consideration in evaluating possible FDI filing requirements.

- Determine, based on the information above, whether the FDI laws in the relevant jurisdictions apply to the contemplated transaction. Particular care should be taken to examine each step of the internal reorganization or spin-off as the need for and timing of any mandatory filings will often depend on the details of the relevant steps.

- Develop a detailed filing plan and timeline with local counsel. Depending on the jurisdictions, complexity of the transaction and type of business involved, approval could take a number of months.

Where required, companies are well advised to start the filing process early to avoid unnecessary delay to the completion of the transaction.

In each case, given the complexity and variety of the various FDI regimes, companies should seek the advice and assistance of counsel. With proper awareness and planning, even a large multinational company with potentially sensitive operations can comply with **various FDI regimes** such that a reorganization or spin-off can be consummated in an efficient manner that does not put the overall transaction at risk.

*With assistance from **Pascal Bine**, **Brian J. Egan**, **Matthias Horbach**, **Akira Kumaki**, **Michael E. Leiter**, **Kathryn Gamble**, **Tatsuya Hasegawa**, **Wesley Lainé**, **Crispin M. Smith** and **Jermaine A. Washington**, Skadden, Arps, Slate, Meagher & Flom LLP*