

# Foreign Direct Investments – Clearance in Europe and the United States

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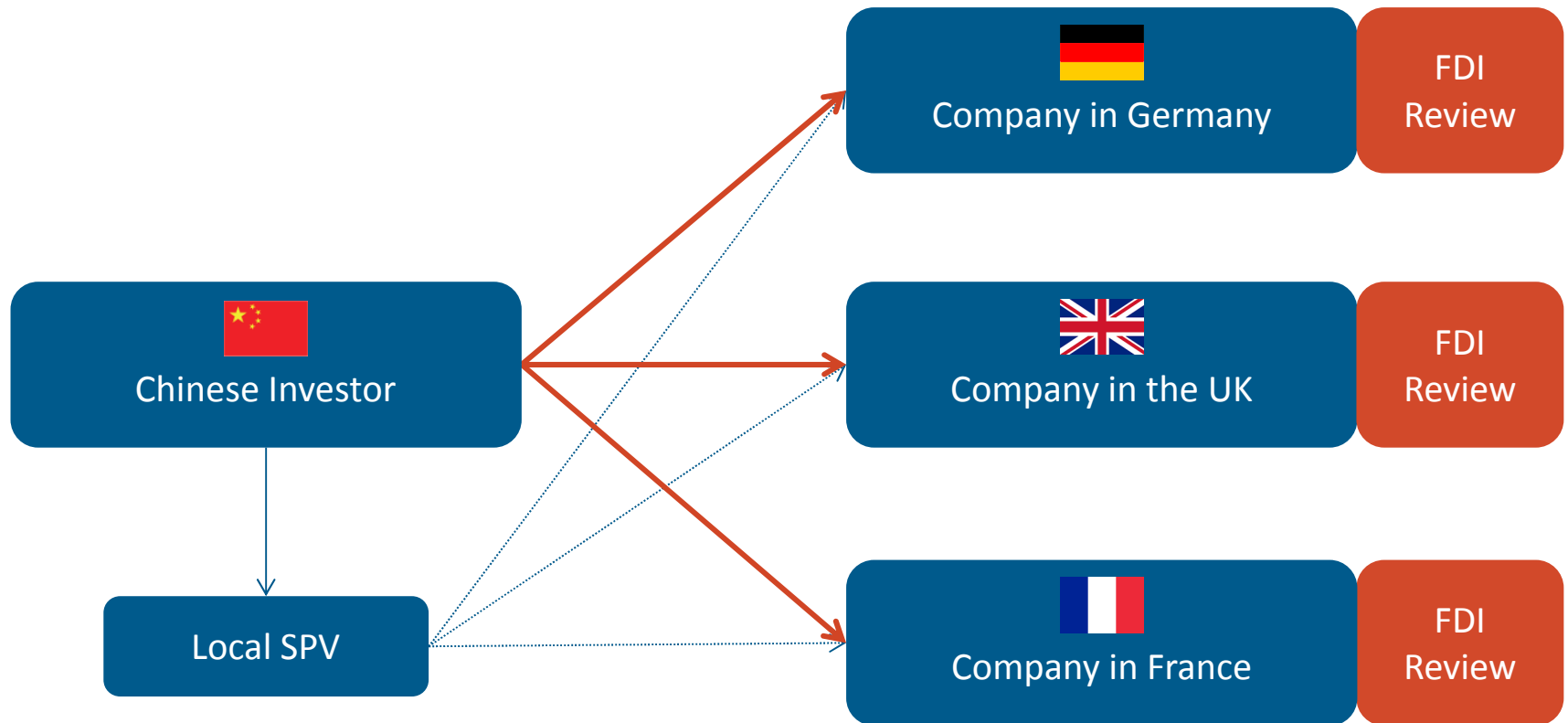
Webinar 1 – 15 November 2017 – Focus: Europe

# Agenda – Webinar 1

	Foreign Direct Investments - Clearance in Europe
I.	German FDI approval regime
II.	Deal preparation / considerations in Germany
III.	UK & French FDI approval regime
IV.	The EU proposal on FDI
V.	Parallels to EU and national merger control regimes
VI.	Some conclusions

# Sample case for FDI review

- Chinese investor intends to acquire directly or indirectly 80% of the shares in a major IT company within the EU operating in the cloud computing business
- FDI review in three EU jurisdictions: Germany, the UK and France



# German FDI approval regime



- Basic approach / structure:
  - Centers around “public order and security” (EU legal term)
  - **Sector-specific approach** (defense- and encryption-related products)
  - **Cross-sector approach** (all industries, in particular “key industries”)
  - Two phase review procedure: **General and in-depth review**
- Administrative coordination under German law:
  - One ministry solely competent for review: Federal Ministry for Economic Affairs and Energy
  - Internal coordination with other ministries and/or authorities (e.g. Federal Ministry of Defense, Federal Cartel Office)
  - Prohibition by the Federal Government (includes all federal ministers and the chancellor)

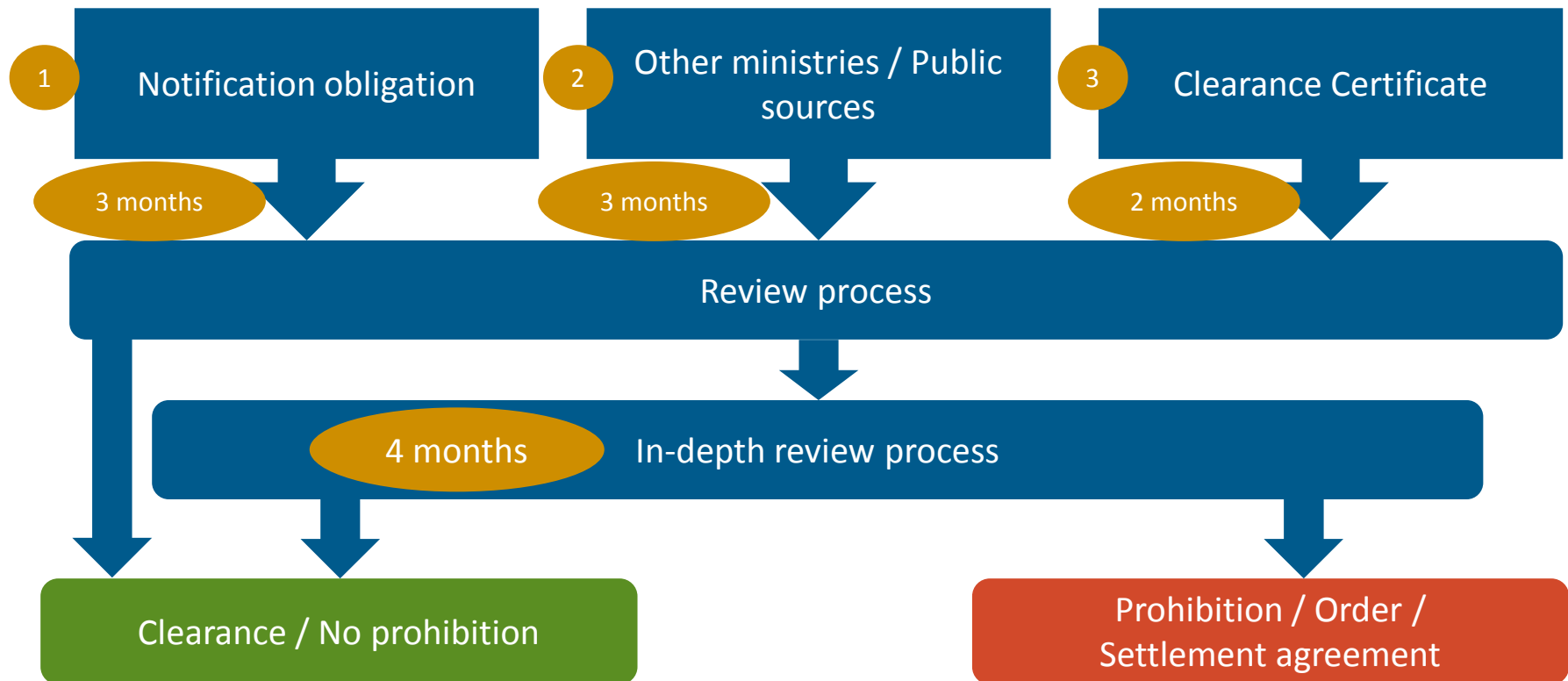
# Recent Amendments to German FDI regime



- Amendments to the *German Foreign Trade Ordinance* in July 2017:
  - Specify **key industries/critical infrastructure as examples for possible threats of public order and security**: telecommunication, water & energy infrastructure, information technology, healthcare, transport, finance, insurance and nutrition (and infrastructure related software providers) → **specification or extension of “public order and security”**?
  - Establish **notification obligation** for FDI re key industries
  - **Longer review periods** → impact on timing and deal certainty
  - Clarify: **indirect acquisitions** via domestic companies are included
- Political objectives:
  - Germany is open for FDI (no prohibitions so far) – but fear of **sell-out**
  - Strengthening mechanisms of **reciprocity** in light of unbalanced trade rules
  - Review focus on “major” cases (also in light of limited capacity)

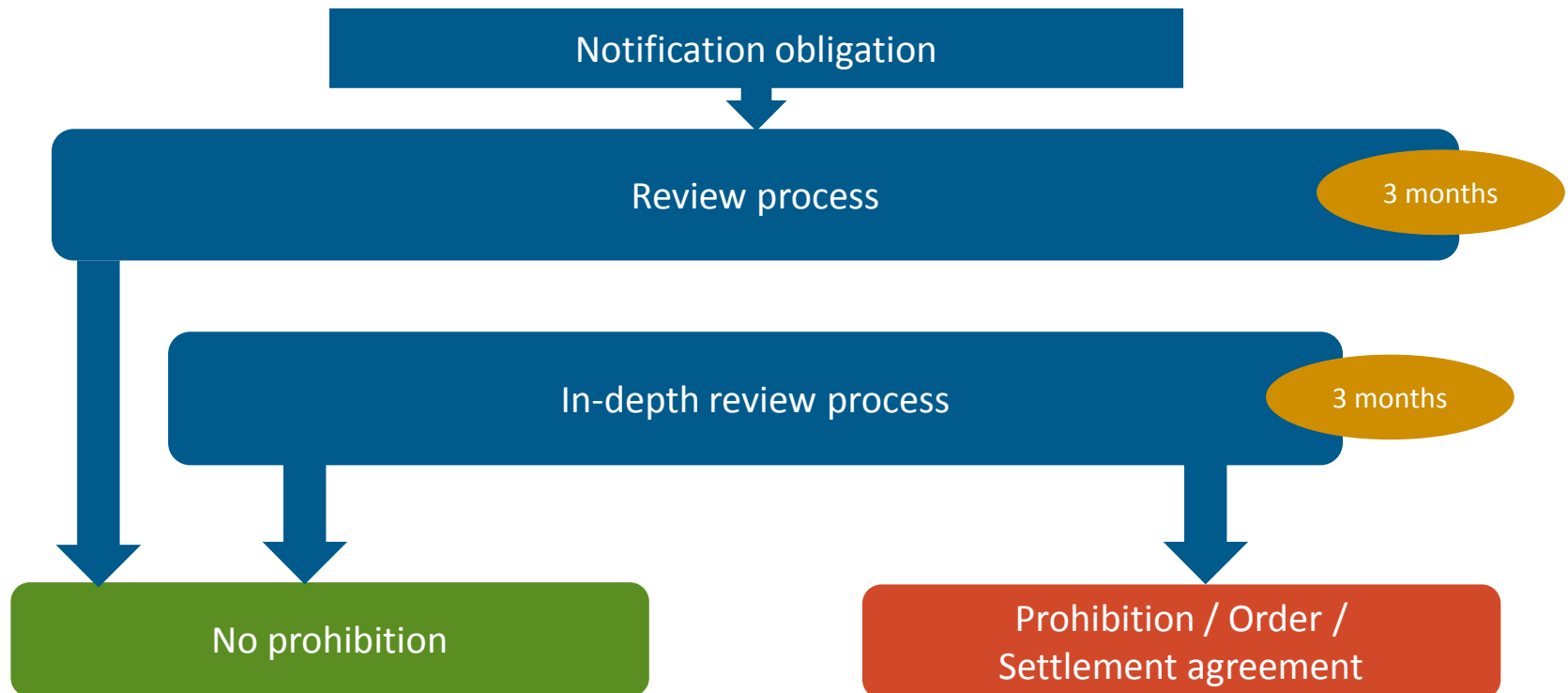
# Cross Sector Approach & Clearance Certificate

Cross Sector Approach	
Applicable for investors:	Non-EU/non-EFTA acquisitions ( $\geq 25$ % of the voting rights)
Target company:	All industries
Notification obligation:	"Key industries" only



# Sector Specific Approach

Sector Specific Approach	
Applicable for investors:	Every foreign acquisition ( $\geq 25\%$ of the voting rights)
Target company:	Defense- and encryption-related products
Notification obligation:	Standard if sector specific approach applicable



# Deal preparation/considerations



- Is the deal subject to FDI review procedure? Target **part of the key industries**? Reserve more time and effort to FDI approval (and planning)
- **Notification obligation**? If yes, notify in order to avoid problems later
- **Clearance Certificate** possible? Best case!
- Unlike merger control there is **no strict prohibition** to execute the transaction – but drastic sanctions (void voting rights, appoint trustee to sell to third party)
- Need of **close coordination** between purchaser, seller and target to file documents with the competent German ministry – makes hostile deals more difficult
- Be prepared to **discuss remedies or conditions** for approval with German ministry
- **SPA provisions** to be negotiated:
  - FDI clearance or “no prohibition” as a condition to closing
  - Risk allocation (hell or high water provisions; break-up-fees, insurance)
  - Cooperation re filing/communicating with the competent ministry

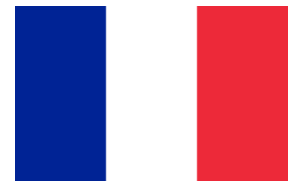


# UK FDI approval regime



- FDI review under the **merger control regime**, competence/scope:
  - Competition and Market Authority (“CMA”); possible intervention of UK government
  - Public interest considerations (i.e. national security, financial stability and media plurality)
  - No notification obligation and no prior clearance
- FDI review under the **Industry Act (1975)**:
  - “Where that change of control would be contrary to the interests of the UK”
  - No prohibition ever under the Industry Act
- **“Golden shares”** in certain UK entities
  - Focus on entities manufacturing defense-related products
  - De facto blocking right for FDI
- Outlook and legislative proposals:
  - Mandatory notification of mergers and FDI?
  - Adjustment of merger thresholds for certain sectors (e.g. defense)?
  - **White paper in 2018** and **impacts of Brexit**

# French FDI approval regime



- **Prior clearance** review procedure for FDI under the Monetary and Financial Code
  - Distinction between EU/EEA investors and non-EU/non-EEA investors

	Non-EU/non-EEA investors	EU/EEA investors
Investment whereas the company must be headquartered in France	<ul style="list-style-type: none"><li>• „Control“ of a company</li><li>• All or part of a branch of activity of a company</li><li>• Acquisition of 33,33% or more of the shares or voting rights</li></ul>	<ul style="list-style-type: none"><li>• „Control“ of a company</li><li>• All or part of a branch of activity of a company</li></ul>
Sectors	<ul style="list-style-type: none"><li>• Defense</li><li>• „Critical“ Infrastructure</li><li>• Certification of IT products</li><li>• Dual-use goods</li><li>• Further sectors included</li></ul>	<ul style="list-style-type: none"><li>• Defense</li><li>• „Critical“ Infrastructure</li></ul>

- Filing for clearance (timeframe: 2 months)
- **Strong own intervention rights** for the target company's management; special voting rights for long-term shareholders and consultation of work councils

# FDI screening – renewed attention at EU and EU Member State level

- Discussions on an EU-wide FDI screening regime existed for a number of years. Initially, the European Commission dismissed the idea of an FDI screening as being inconsistent with the EU's open investment policy.
- But, discussions accelerated especially in 2016 – 2017 against the background of some foreign investments drawing substantial political attention (for example: the withdrawal of German clearance for the acquisition of Aixtron by a Chinese investment fund).
- There was a growing concern for
  - the need to protect strategic sectors especially vis-à-vis State-subsidized investors and
  - the need for a level playing field for EU investors in third countries.
- In spring 2017, France, Germany and Italy and later the European Parliament requested the European Commission to address the issue.
- Ultimately, on 13 September 2017, the European Commission issued its Proposal for a Regulation establishing a framework for screening foreign direct investments into the EU.

**See:** European Commission, Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union. Available at: <http://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-487-F1-EN-MAIN-PART-1.PDF>.

# FDI review in Europe: the EU proposal

## Content of EU proposal

What is covered by the EU proposal are “foreign direct investments”.

= This requires the existence of

- an economic activity in an EU Member State and
- can include investments that enable effective participation in the management or control of a company carrying out such an economic activity.

It excludes portfolio management.

The investor must be

- a natural person or
- an undertaking

of a third country which will make or has made a foreign direct investment.

But, intra-EU transactions can be subject to FDI screening if they seek to circumvent the applicable FDI-screening framework. This would be the case where the EU investor is ultimately owned or controlled by a natural person or an undertaking of a third country.

# FDI review in Europe: the EU proposal (ct'd)

## Content of EU proposal

As was mentioned earlier, FDIs can only be screened “on grounds of security and public order”.

In doing so, the potential effects on the following **MAY** be considered

- (i) critical infrastructure (including energy, transport, communications, data storage, space or financial infrastructure, as well as sensitive facilities)
- (ii) critical technologies (including artificial intelligence, robotics, semiconductors, technologies with potential dual use applications, cyber security, space or nuclear technology)
- (iii) the security of supply of critical inputs, or
- (iv) access to or control of sensitive information.

This list is not binding. Member States or the European Commission may take other factors into consideration.

As well, in determining whether to screen or whether an FDI affects security and public order, the fact that the FDI is made by a foreign investor that is controlled or significantly funded by the government of a third country will be taken into account.

# FDI review in Europe: the EU proposal (ct'd)

The EU proposal does not result in a fully detailed FDI screening regime but aims at setting up a framework that allows flexibility to Member States to take into account their individual situations and national circumstances.

## Implications of the framework at the level of the EU Member States

In the first place, Member States are not required to set up an FDI screening regime.

If they do, they must however abide by the minimum requirements established in the proposed regulation.

These minimum requirements refer to

- (i) transparency and non-discriminatory treatment,
- (ii) setting out the circumstances triggering the screening, the grounds for screening and the applicable detailed procedural rules,
- (iii) establishing timeframes for issuing screening decisions, which must take account of the delay allowed for Member States to comment and for the Commission to issue an opinion,
- (iv) making sure that confidential information submitted by foreign investors is protected,
- (v) offering judicial redress against a screening decision.

# FDI review in Europe: the EU proposal (ct'd)

## Implications of the framework at the level of the EU Member States

The EU Member States and the European Commission must cooperate. This means that:

- (i) The EU Member States must inform the Commission and the other Member States of FDI screening.
- (ii) Regardless of whether FDI screening is taking place in the country of investment, Member States may provide 'comments' and the European Commission may issue an opinion on any FDI planned or completed. The European Commission can do so even if no Member State has commented.
- (iii) The Member States and Commission may request any information necessary from the Member State in which the investment is made or planned.

Comments by other Member States and opinions received from the Commission are **not** binding on the Member State of investment. It must only give '*due consideration*' to these comments or opinion.

# FDI review in Europe: the EU proposal (ct'd)

## Implications of the framework for screening at the level of the EU Commission

The Commission itself will be entitled to screen FDIs if the investments in question are likely to affect projects or programmes of Union interest .

= These are projects and programmes which involve a substantial amount or a significant share of EU funding, or which are covered by Union legislation regarding critical infrastructure, critical technologies or critical inputs.

An indicative list has been given which includes for example:

- (i) European GNSS programmes (Galileo & EGNOS, which are satellite navigation systems),
- (ii) Trans-European Networks for Transport, for Energy and for Telecommunications.

As the list is indicative, other projects or programmes may be taken in to account.

Thus, for example, the papers accompanying the proposal make reference to sectors such as the energy sector, certain raw materials, the cyber security and electronic communications sector, the air transport sector, the financial sector or dual-use items.



# FDI review in Europe: the EU proposal (ct'd)

## Implications of the framework for screening at the level of the EU Commission

When the Commission determines itself that a FDI is likely to affect projects or programmes of Union interest on grounds of security or public order, it may:

- (i) issue an opinion to the Member State where the FDI is planned or has been completed, and / or
- (ii) request any information it deems necessary to issue its opinion.

This European Commission's opinion is still not binding on the EU Member State that must nevertheless take "*utmost account*" of the opinion.

The Member State must also provide an explanation to the Commission in case this opinion is not followed.

Although non-binding, the opinion of the Commission in those screening processes would therefore bear a certain weight.

# FDI review in Europe: the EU proposal (ct'd)

- In sum, the proposed Regulation should increase the transparency, predictability and reliability of the FDI screening mechanisms implemented by the Member States.

However, it should only have a limited impact on the actual harmonization of FDI screening mechanisms in the EU Member States. By way of example:

(i) The factors to be taken into account provide an illustrative, non-exhaustive list of factors that may be taken into account in determining whether a foreign direct investment may impact security or public order. All sectors may therefore be concerned by an FDI screening mechanism, provided such screening is based on the grounds of security or public order.

(ii) Investment thresholds triggering the application of a FDI screening mechanism will be harmonized to a limited extent given the "vague" wording of the definition of "FDI" in the proposed Regulation. The notion of *"effective participation in the management or control of a company carrying out an economic activity"* seems to refer to the notion of "control" rather than a specific degree of ownership and offers flexibility to the EU Member States.

- On the other hand, the cooperation mechanism and the implementation of a more structured framework of exchange of information and best practices may lead to additional coordination in the application of domestic laws and regulations on the screening of FDIs. Additional scrutiny of FDIs is likely to occur.

# FDI review in Europe: the EU proposal (ct'd)

- **Status**: its adoption, ultimate content and the timing for adoption is uncertain.

The proposal must go through the legislative procedure entailing a review by the EU Member States in the Council and a review by the European Parliament. And that process may be long and arduous as each of the Council and Parliament may lodge amending proposals which will then have to be reviewed by the European Commission to try and arrive at a compromise.

- This process is rendered even more complex by the following :

(i) whilst Germany, France and Italy welcomed the Commission's proposal, Southern and Eastern countries such as Estonia have voiced concerns. And Estonia – which is currently assuming the Presidency of the Council – has decided to refer the proposed Regulation to a working group of trade defense experts where only one meeting is reported to have taken place;

(ii) other countries like the Netherlands, Finland, Sweden and Denmark, i.e., typically the more trade-liberal EU Member States, have been reported to be critical as well

(iii) only last week, it was reported that a group of EU countries including Greece, Finland and Portugal have requested that the European Commission prepare an impact assessment of the proposal before discussions on the proposal itself take place.

# Parallels to EU and national merger control regimes

- EU merger control regime **provides** a **one-stop shop** and **excludes national intervention**
  - Exception: Member States can protect **legitimate interests** other than relating to competition (e.g. public security)
- Significant **increase of merger control regimes** worldwide in the last two decades
- Enormous **impact on transactions**
  - Antitrust feasibility & risks
  - Risk allocation
  - Timing
  - Costs
- Analysis of merger control implications is a **commonplace element**

# Parallels to EU and national merger control regimes

- A European FDI **one-stop shop** is **not** likely
  - Multitude of FDI control regimes within the EU and worldwide
  - FDI control regimes in parallel to merger control investigations
  - Similar/different substantive tests
  - Much greater political assessment
  - Greater discretion
- **Global convergence** – as largely seen in merger control – **likely?**
- **Practical suggestions**
  - Like in merger control, **early identification** of FDI notification requirements **recommended**
  - Is notification **mandatory** or **voluntary**?

# Parallels to EU and national merger control regimes

- **Practical suggestions** (cont'd)

- Is approval/non-intervention decision **needed for closing**?
- If not, what are the **risks** of intervention and subsequent prohibition?
- In part **identical/similar elements** of **FDI** and **merger notification**
  - E.g., transaction structure, corporate structure of the parties, activities of the parties, strategy, annual report
- **"Consistency is king"**
  - Between FDI submissions worldwide and
  - Between FDI and merger control submissions
- **Information exchanges** between authorities and governmental units
  - German antitrust authority (*Bundeskartellamt*) may inform the German Ministry for Economic Affairs and Energy
- Consider **timing** implications

# Some Conclusions

- Focus should be on national FDI approval regimes (but keep in mind that EU may do something over time)
- Expect more rigid and more granular approach of competent authorities compared to the past
- FDI approval may become a legal and also a political hurdle for transactions
- New hurdles and related issues can be dealt with - but additional intelligence, time and effort are required for planning, preparing and obtaining a positive FDI approval decision

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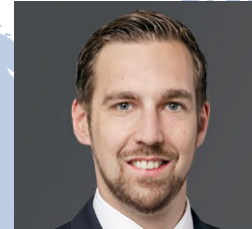


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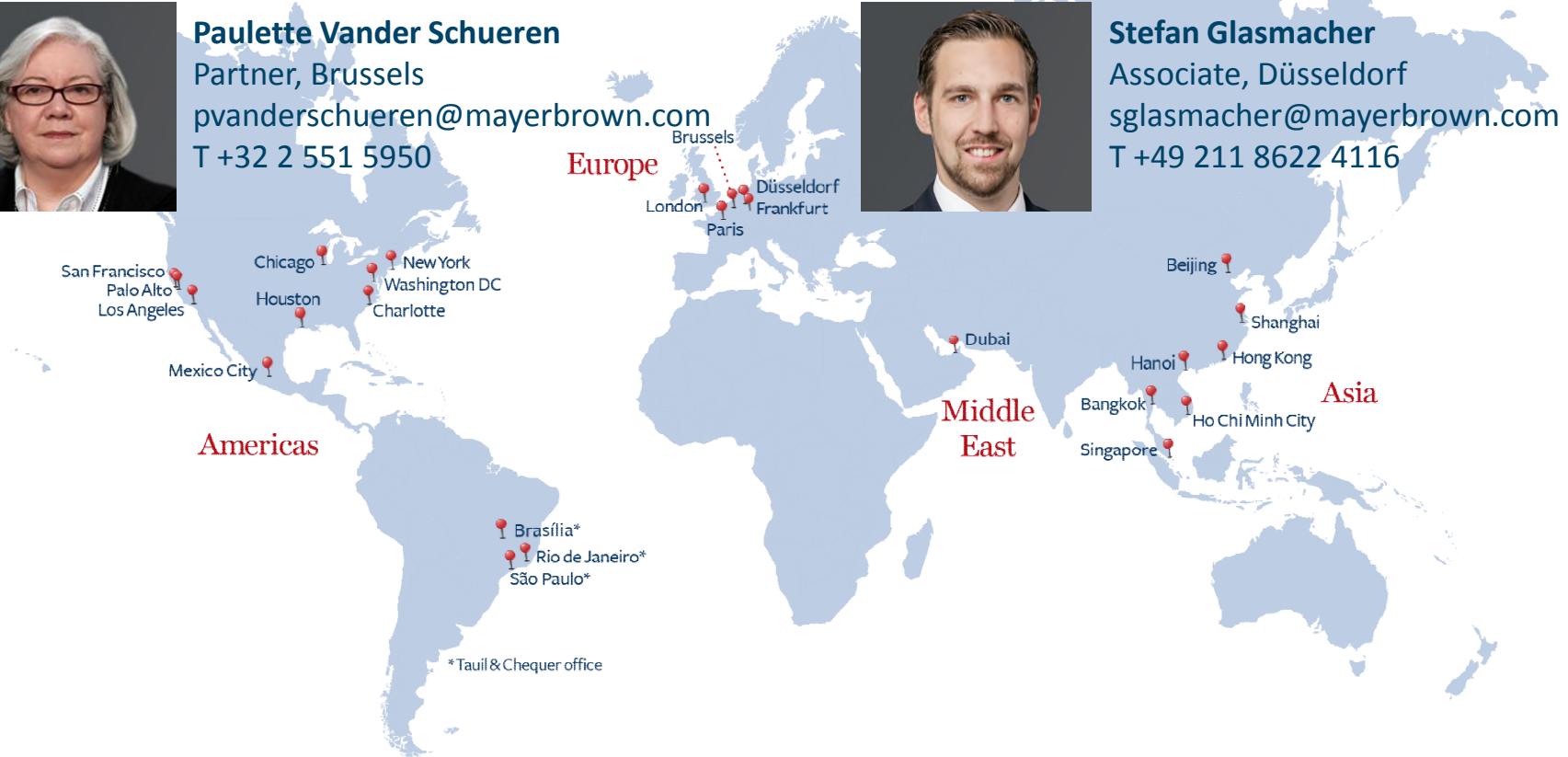


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