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Foreign investment monitor

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Freshfields Bruckhaus Deringer

Welcome to Freshfields' foreign investment monitor

The regulatory environment in which investors and multinational corporations operate is more complex and volatile than ever. This is particularly true when it comes to rapidly evolving foreign investment laws.

Coming off a resurgent M&A market in the second half of 2020, there is optimism that opportunities for deal-making will continue to grow in 2021. However, there are also increasing challenges, with regulatory intervention still a leading cause of deal collapse.

Economic conditions remain uncertain with the pandemic not yet fully under control, and geopolitical tensions, particularly between the United States and China, show no signs of easing. Against this backdrop, foreign investment regimes are being implemented and amended at speed. Governments and regulators continue to test new areas of national security concern – including evolving threats around cyber security, critical technology and critical supply chains – and face increased political pressure to take a more protectionist stance.

In this new quarterly publication, a companion piece to our M&A monitor, we are excited to share key issues for investors, updates on forthcoming legislative changes, and practical guidance on how to navigate the global foreign investment landscape.

Delivering success in today's environment requires a sophisticated understanding of this rapidly changing landscape. We have extensive experience of seamlessly managing foreign investment and national security risk assessments and regulatory review processes on transactions across a range of industries and jurisdictions. Our international team combines depth drawn from experience both in and out of government.

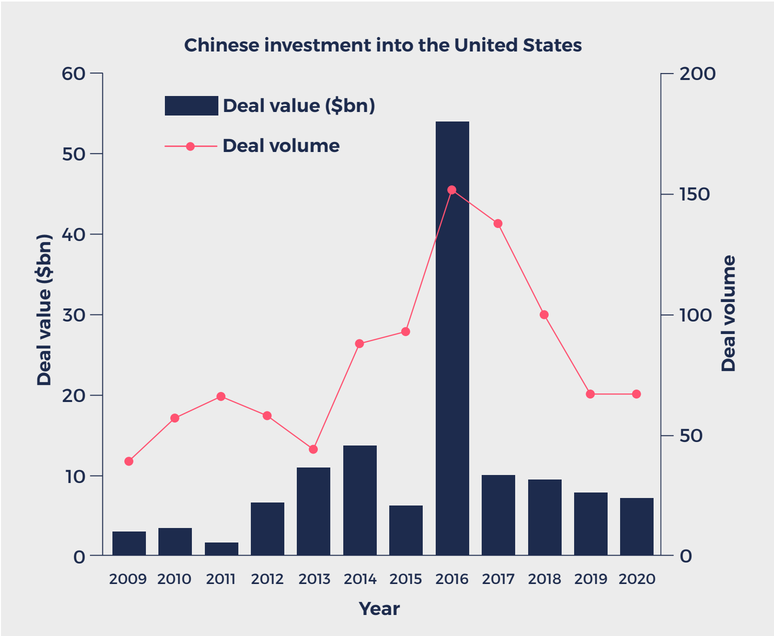
With the most up-to-date insights, careful preparation and our leading team of foreign investment practitioners at your disposal, you can pursue your critical transactions with confidence.

Aimen Mir
Partner, Washington, DC

Alastair Mordaunt
Partner, Hong Kong

Where next for US–China relations?

He may have spent the early months of his presidency reversing much of his predecessor's legacy, but Joe Biden is unlikely to stray too far from Donald Trump when it comes to China. Not only have senior officials in his administration labeled China as America's "greatest long-term security threat," but the president himself has ordered an urgent review of critical supply chains to cut US dependence on its geopolitical rivals. At the same time, the Department of Commerce has allowed a sweeping Trump-era supply chain regulation that designates China as a "foreign adversary" to come into effect. Recent talks between the two countries in Alaska were as fiery as anything seen during the previous administration.



Concern over Beijing's use of industrial policy and foreign investment to advance its strategic ambitions grew during the latter years of the Obama administration, with several Chinese deals formally or effectively blocked based on risks identified by the Committee on Foreign Investment in the United States (CFIUS). With President Trump equating economic and national security from the outset of his presidency – and bi-partisan concerns in Congress leading to an expansion of CFIUS's remit – Chinese deal value dropped to around 15 percent of its 2016 peak by the end of Trump's term (although Beijing was also putting the brakes on speculative acquisitions and transactions that didn't align with its goals).

The Biden administration, thus far, has emphasized the need to ensure US technological leadership, although it remains to be seen whether this will lead to greater intervention in technology deals even where there is no clear nexus to the PRC. But when it comes to CFIUS's substantive risk analysis of Chinese deals, the next four years are likely to look very much like the last. That said, Colin Costello, who until recently led the intelligence community's analytic support to CFIUS before joining Freshfields' Washington, DC office, believes there will be changes at the margins that businesses need to understand.

Administration officials are expected to let CFIUS reviews run their course.

"The Trump administration had almost no appetite for mitigation to address risk in relation to Chinese investment," he says. "That's unlikely to be the case under Biden, where CFIUS may be more willing to entertain discussions of mitigation in borderline cases

> **Under Biden, CFIUS may be more willing to entertain discussions of mitigation in certain borderline cases.**

unless the target involves advanced technology, critical infrastructure or sensitive personal data. Even there, senior administration officials will very likely let CFIUS reviews run their course rather than prematurely interjecting themselves into the committee's deliberative process. Looking at the transactions prohibited by President Trump, some would almost certainly still be blocked today, but others might be cleared subject to significant mitigation. We're also likely to see a return to CFIUS as a 'black box' organization. The committee has always been tight-lipped on ongoing reviews but toward the end of Trump's term there was a lot of committee business discussed in the press." Partner Aimen Mir, who joined Freshfields in 2018 after 10 years in leadership positions at CFIUS, including four as its most senior career official, also highlights dramatic increases in the committee's budget. "With more resources we may see more predictable timelines as CFIUS's bandwidth expands," he says. "But we're also likely to see deeper review of all transactions filed with the committee. Mitigation may be pursued as an option in deals where previously the risk wouldn't have warranted it, and more manpower may be devoted to scrutinizing non-notified deals – meaning more transactions could be called in for review post-closing."

The desire to safeguard US technology, infrastructure and sensitive personal data has implications for all international acquirers, not just those with direct ties to Beijing. Colin stresses that companies considering such investments – particularly if they carry a mandatory filing requirement – must be mindful of how CFIUS analyzes deals. While the committee's political appointees change with each administration, there is much less turnover among the career staff who perform most of the substantive risk analysis and formulate recommendations. This community has come to accept that commercial ties can represent a significant vector of risk, especially in transactions involving advanced technology that may have military applications. "A company might view a supplier relationship or joint venture with a Chinese company as a purely commercial matter, but CFIUS might view it as a potential route for technology transfer," he says.

Geopolitics, trade and investment in the year ahead

How will international trade and broader geopolitical dynamics affect cross-border investment in 2021? Will President Biden reinvigorate the Western alliance, or is the EU/China trade deal a sign that times have changed? Does the UK look East or West after Brexit? And what's on President Xi's priority list? We asked four of our partners for a global perspective.

Aimen Mir,
Washington, DC

The Trump administration's approach resulted in the EU becoming more independent on the global stage, and the conclusion of talks over the EU–China Comprehensive Investment Agreement was a good example of that.

However, President Biden is committed to much closer collaboration with America's traditional allies, and recent coordinated sanctions on China between the United States, EU and UK are a sign of how things have changed. There appears to be a willingness among most EU member states to work with the United States on a common approach to technology protection, governance and innovation that would curb Chinese efforts to export its standards. President Biden will be a familiar partner, for sure, but EU leaders will likely reengage with one eye on underlying political trends in the United States and what might happen in four years' time. As far as US relations with Beijing go, the fundamental economic and security concerns of the Trump era remain, and the tone of the early diplomatic engagement between the new administration and China points to the challenges that lie ahead. However, we may see more nuance to enable the two countries to work together in pursuit of progress on areas of common interest. Priorities such as climate change that require international cooperation in turn could drive more cross-border investment, at least among like-minded countries.

Heiner Braun,
Frankfurt

Europe has become a much trickier destination for Chinese investors than it was in 2016 when inbound capital flows were at their peak. We're still seeing interest in European assets, although the deals aren't particularly big or strategic in response to the constant messaging from European governments that such transactions – i.e. investments in sectors and industries where China still needs to catch up with the West – are no longer really welcome.

If the EU–China investment deal is approved – and that's by no means certain – there is nothing in it that stops member states using their existing FDI review powers to block prospective Chinese investments on national interest grounds. It will therefore be interesting to see what impact future decisions of this nature will have on trade relations between the two sides. The irony is that, at the same time, China has been relaxing its rules for foreign investment, and European industries such as automotive and machinery are ever-more reliant on the Chinese market as the pandemic has suppressed domestic demand. As Aimen says, Europe has become more independent from the United States in recent years, but its positioning vis-à-vis China remains an as yet unresolved conundrum.

Michele Davis,
London

The UK has traditionally been one of the most open economies to foreign investment in the world.

However, since he was appointed 12 months ago, the UK government's investment minister, Lord Grimstone, has been working hard to reassure overseas investors that this is still the case in the post-Brexit era in light of the UK's new National Security and Investment Bill. The Bill introduces a mandatory notification regime for national security screening of deals in a number of "sensitive" sectors, and we've been talking to investors who are having second thoughts about investing in the UK – between the legislation and the perception that the Competition and Markets Authority has become a more aggressive and interventionist regulator, they're worried about their ability to exit those investments. The government has a difficult job on its hands navigating the current diplomatic environment and proving that the new rules are apolitical. But the UK's trade position post-Brexit, COVID-19 and the change of US administration means it needs foreign investment, so it has to get the balance right.

Hazel Yin,
Beijing

Much like the UK, China is pursuing two policies that appear contradictory – on the one hand continuously opening its domestic industries to overseas investors while on the other increasing its screening of foreign investment on national security grounds.

The national security regime has been in place for some time, but the government has only recently started to launch more investigations. However, for the time being it's not expected to be enforced as actively as China's merger control rules. 2021 marks the first year of the implementation of the 14th Five-Year Plan (2021–2025), with the Chinese government pursuing "high-quality" rather than "high-speed" growth and "high-end, intelligent and green production." Foreign investment in these areas will continue to be welcomed and China's national security rules will more likely be applied as a "defensive" measure instead of too intrusively to deter overseas capital.

How fast-changing FDI regimes impact "in-flight" deals

In the past year, jurisdictions across the world have introduced new or amended existing foreign investment laws at a faster pace than ever, making deal planning more complex for buyers and sellers alike. Ever-changing foreign investment laws require parties to continuously evaluate their filing obligations – no longer just at the pre-signing stage, but during the entire sign-to-close period – to manage (and respond to) unforeseen delays and costs.

A particular foreign direct investment (FDI) risk area that has emerged in the past year relates to the situation where regulators introduce laws while a deal is "in flight" in a bid to capture a particular deal or protect certain newly emerging risks with retroactive effect.

- After the Hong Kong Exchange announced its hostile bid for the London Stock Exchange – which included the Borsa Italiana Group – the Italian government rapidly approved new measures giving it the right to use special powers to protect the Milan exchange from any unwanted foreign investment. These changes were adopted within days and with almost immediate effect.
- In March 2020, the Spanish government approved foreign investment legislation in response to the effects of the COVID-19 pandemic, which applied retroactively to transactions with agreements dated before the amended rules had come into effect that had not yet closed.
- In November 2020, the UK government published draft legislation which, notwithstanding the fact that it has yet to be formally adopted into law, already contains powers that apply retrospectively to any deals that signed but had not yet closed on the date (or any time after) the draft bill was announced.
- The EU FDI regime is now being used by some member states' national agencies to effectively buy extra time and extend reviews beyond their national statutory assessment periods. This is another novel strategy by regulators that has impacted deal timetables in the past year.

While fast-evolving laws can introduce unexpected risk, continued analysis and horizon-scanning (especially of the political landscape and public perceptions of the transaction) can help anticipate and mitigate it. Parties should assess potential political concerns during early-stage deal analysis and, depending on the level of sensitivity, allow for sufficient contractual flexibility combined with proactive stakeholder outreach during the sign-to-close period.

> "With laws evolving quickly, parties should assess political risk during early-stage deal analysis.

France uses expanded powers to block two deals

> The Carrefour decision shows France is willing to adopt a broad interpretation of what it considers "critical" sectors.

While prohibition cases in Europe have remained rare so far, the end of 2020 and beginning of 2021 saw the French government block two deals in quick succession under its strengthened and expanded foreign investment review regime.

The proposed acquisition of France's leading retailer, Carrefour, by Canadian convenience store chain Couche-Tard was nipped in the bud by French Minister of Economy Bruno Le Maire. Just days after the bid was announced he sent a "courteous, clear and definitive no" to the Canadian group, before any formal notification on the investor's side. By considering the proposed transaction between two food retail groups as involving a strategic sector on the basis that it impacted France's food security, the government showed its willingness to adopt a broad interpretation of its ever-growing list of strategic sectors, thereby expanding its reach to "several thousands of companies," as acknowledged by M. Le Maire.

By contrast, the prohibition of the acquisition of military solutions pioneer Photonis by US defense manufacturer Teledyne was not so clear-cut. The decision ended a tumultuous saga after almost a year of negotiations between the French government and the US conglomerate. Initially, the government was focused on designing a package of commitments for Teledyne that would protect France's strategic interests while preserving its economic attractiveness. And by the end of 2020, Teledyne had finally agreed to a set of stringent conditions, notably granting a minority shareholding interest and veto rights to the French public investment bank, Bpifrance. Yet, the government, through Defense Minister Florence Parly, announced a U-turn at the last minute, concluding Photonis's activities were too strategic to be managed by a non-French player, irrespective of any potential commitments. Photonis was subsequently acquired by HLD, the French investment group, for €370m, much less than the €500m Teledyne was initially offering.

Both cases illustrate France's clear commitment toward favoring the protection of its national interests over its economic attractiveness, particularly in the context of the pandemic. From a practical perspective, future foreign investors will have to face a government with increasingly broad and flexible review powers targeted at protecting the French national interest.

Bruno Le Maire blocked Canada's Couche-Tard from acquiring retailer Carrefour.

Germany prohibits telecoms buyout as it aims to strengthen FDI screening powers

The German Ministry for Economic Affairs and Energy recently stepped in to stop Addsino – a subsidiary of Chinese state-owned defense company CASIC – acquiring technology communications company IMST over the deal's potential to threaten public order and security.

Addsino's bid for telecoms company IMST was blocked by the German government.

In a rare prohibition, the ministry emphasized that IMST, which has received significant public funding in the past, has security-critical know-how in the field of satellite communication, radar and radio technology that is deemed vital to Germany's technological sovereignty. The ministry said it considers IMST's knowledge important to the development of critical infrastructure such as 5G and 6G. IMST has been an important partner of the German Aerospace Center and has supplied products and services to the German armed forces.

The decision is set against the backdrop of moves by the government to further tighten Germany's foreign investment screening rules. In January, the ministry published a draft regulation that follows suggestions from the EU Screening Regulation and contains clarifications on a variety of further issues.

Among other things, the draft would extend the number of categories that trigger a mandatory filing from 11 to 27, with the additions relating mostly to critical technologies and critical inputs. In the defense sector, deals involving goods that are either export controlled or based on secret IP rights would require a mandatory notification.

The draft also proposes broadening the scope of review to include the acquisition of voting rights above the current thresholds of 10 percent and 25 percent. Below these limits, acquisitions may in the future also be subject to foreign investment controls if the investor acquires other means of influence, for example through board seats, veto or information rights or where parallel investments by different state investors jointly exceed the relevant thresholds.

So, while the IMST case may be a rarity, the proposed new rules clearly indicate the German government's desire to extend its jurisdiction to review FDI and apply strict scrutiny to cases that it considers may have an impact on public order and security.