

# The Rise of Western Protectionism Is Set to Impact Global M&A

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This year has seen a surge in western protectionist sentiment as a number of countries have sought to introduce legislation to tighten their laws on foreign investment and public interest issues.

In Europe, the European Commission (the **Commission**) has yielded to pressure from certain Member States (namely, Germany, France and Italy) to introduce proposals for a joint foreign investment control regime at EU level. In addition, some European Member States have introduced their own legislation to review foreign investments. For example, in July, Germany adopted an amendment to the German Foreign Trade and Payments Ordinance regime to allow the German government to review and block certain acquisitions of domestic companies by non-EU investors. In the wake of Brexit in the UK, the UK government has recently published proposals to enable it to intervene in a broad range of transactions that raise national security concerns. In Canada, national security reviews have become significantly more frequent in recent years, while, in the U.S., the Committee on Foreign Investment in the United States (**CFIUS**) has shown an increased readiness to intervene on national security grounds, and earlier this month both houses of Congress introduced bills to modernize and strengthen the review by CFIUS.

With the rise of this interventionist approach, it is clear that global investors are now operating in a different legal environment and are likely to feel the impact when seeking to invest in nationally important targets that fall within the remit of these foreign investment rules.

## European Commission

On 13 September, the Commission announced a draft proposal to introduce EU-wide screening of foreign direct investments on a range of public order and security grounds, including investments in critical infrastructure, technologies, including key enabling technologies, and inputs which are essential for security or the maintenance of public order. Under the proposal, the Commission is afforded the power to review and provide an opinion on investments of "Union interest".

The proposal provides an option (although not an obligation) for Member States to put in place a mechanism to screen foreign direct investments on grounds of security or public order. If these proposals are adopted, the Commission will be able to address an opinion where it considers that the investment is of "Union interest" and the Member State would then have to take "utmost account of the Commission's opinion and provide an explanation to the Commission in case its opinion is not followed".

The draft proposal also envisages introducing a cooperation mechanism to ensure better coordination between Member States and the Commission of ongoing national security reviews that are not of "Union interest". Although the Member State in question would retain the ultimate decision-making power in those circumstances, the Commission would be able to issue the Member State with a non-binding opinion, while other Member States would be able to make comments, to which the Member State where the foreign direct investment is planned would be required to give "due consideration".

The proposed legislation applies to all foreign investors in the EU and provides that Member States may have regard to whether the foreign investor is controlled by the government of a third country, including through significant funding, when considering whether a foreign investment would be likely to affect security or public order.

The Commission's proposed draft regulation will now be negotiated and finally approved by all Member States and the European Parliament and is expected to finally take effect by the end of 2018, at the earliest. However, it seems likely that concerns recently raised by a group of EU countries, including Finland, Portugal and Greece, demanding an impact assessment of the proposals may slow down this process.

## **Germany**

On 12 July, the German federal government enacted a Regulation to amend the German Foreign Trade and Payments Ordinance (the **Ordinance**) in order to tighten the review of acquisitions by non-EU/EFTA investors in German companies that are active in security sensitive areas. Under the Ordinance, the BMWi can review, prohibit or restrict a direct or indirect acquisition of at least 25% of the voting rights of a German company by a non-EU/EFTA company. The Ordinance lists illustrative and non-exhaustive examples of security sensitive areas which include German companies operating (or developing software for) critical infrastructures, including energy, information technology and telecommunication, transport and traffic, health, water, food, finance and insurance.

Certain acquisitions of companies active in these areas are subject to a mandatory notification to the German Federal Ministry of Economics and Technology (**BMWi**). The amended Ordinance also provides for a mechanism to prevent transaction structures aimed at circumventing the regime.

The amendment to the Ordinance extends the BMWi's review period from two to four months. The BMWi's ability to initiate a review is also extended from three months following the execution of the agreement to three months from the date on which the BMWi becomes aware of the execution of the agreement. The limitation period for the BMWi to investigate a transaction is five years following the execution of the agreement.

As a result of these amendments, we expect that deals involving German targets active in critical industry sectors will be subject to increased scrutiny, while the new extended deadlines are likely to postpone any deal certainty to a later date.

## **UK**

On 17 October, the UK government published a Green Paper proposing both short-term steps (the **Short-Term Reforms**) and long-term reforms (the **Long-Term Reforms**) to expand the government's powers to scrutinise investments that raise national security concerns. Currently, the UK Secretary of State can only intervene in merger cases that raise public interest grounds relating to national security, plurality of the media and the stability of the UK financial system and only (except in a very limited number of cases) where the jurisdictional thresholds are met.

Under the Short-Term Reforms, the UK government is proposing "as a matter of urgency" amending the existing turnover threshold from £70 million to £1 million and removing the increment requirement under the alternative 25% share of supply test in two sectors: (i) the dual use and military sector (the design and production of military items and dual use items which could have both military and civilian uses); and (ii) parts of the advanced technology sector (including multi-purpose computing hardware and quantum-based technology).

The UK government's proposals under the Long-Term Reforms are at an earlier stage of development but examine the possibility of introducing a broader call in power for transactions raising national security concerns, as well as the introduction of a mandatory notification regime for foreign investments in targets active in a specified set of "essential functions".

## **U.S.**

On 8 November, U.S. Senators, along with the Chairman of the Senate Select Committee on Intelligence, introduced a bipartisan bill, the Foreign Investment Risk Review Modernization Act (**FIRREA**), to "modernize and strengthen" the review by CFIUS in order to "ensure the process addresses today's national security issues".

U.S. Senator Cornyn commented that "[b]y exploiting gaps in the existing CFIUS review process, potential adversaries, such as China, have been effectively degrading our country's military technology edge by acquiring, and otherwise investing in, U.S. companies. This undermines our national security and highlights the imperative of modernizing the CFIUS review process to address 21st century threats."

FIRREA is expected to extend CFIUS's jurisdiction to include certain joint ventures, minority stake acquisitions and real estate investments near military bases or other sensitive national security locations. It also will amend the definition of "critical technologies" to include emerging technologies and add national security factors to be considered, and scale back the current safe harbours for passive investors. It will also allow foreign investors to notify streamlined filings to CFIUS for certain types of transactions and authorize CFIUS to exempt certain transactions where the investors are from countries meeting certain criteria.

The Trump administration has been a strong advocate of CFIUS reform, having recently blocked Chinese-backed Canyon Bridge's acquisition of Lattice Semiconductor following a unanimous recommendation from CFIUS, while a number of other investors have abandoned their transactions this year after lengthy reviews by CFIUS. The proposed legislation also takes aim directly at certain countries "of special concern", would make filings mandatory in certain cases, and encourages other countries to adopt similar protections.

## **Canada**

In Canada, the current Liberal government has shifted its policy in the opposite direction by showing an increased openness to investment from China (even reversing a divestiture order of the prior government), while seeking to boost foreign investment by increasing the financial thresholds used to regulate investments in Canadian businesses by investors from the EU, the U.S. and a select group of other countries that have a free trade agreement with Canada.

While it is expected that fewer deals will be challenged on national security grounds as a result of these changes, national security reviews are becoming increasingly complex.

National security reviews can be initiated up to 45 days after notification, which may be made either pre- or post- closing. In recent years, the regulators have tended to make full use of the initial informal 45 day review period before deciding whether or not to initiate a formal review. The majority of transactions that are subject to a formal review are either blocked or result in a divestiture order.

## **Concluding remarks**

It remains to be seen what impact these regulatory changes will have on M&A activity and how governments seeking to bring in these reforms will find the resources to implement them (note, the U.S. proposal includes a filing fee provision, a first for CFIUS). However, as the level of regulatory scrutiny increases, it will clearly become increasingly important for foreign investors looking to acquire nationally important targets to engage with deal parties and the regulators at the earliest possible opportunity, and to factor conditionality and timing implications into their deals.

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