

# France's reinforced control over foreign direct investments in the COVID-19 environment

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The COVID-19 crisis has highlighted, in a dramatic way, the issues that a country may face if it loses control over certain strategic sectors of its economy to foreign interests.

Like other countries in the world, France has had in place for many years a mechanism to screen foreign direct investments ("FDI") in strategic sectors, but over the last year it has adopted legislation to markedly reinforce that mechanism, consistent with a global trend developing even before the COVID-19 pandemic.

Foreign investors contemplating an investment in France<sup>1</sup> should expect an environment of stricter scrutiny of proposed transactions from the perspective of FDI regulations, and probably the adoption of additional protective measures to ensure French control of sensitive activities, such as the measures adopted or announced by the French government in the last few months and described below.

With this in mind, this article provides an overview of the current French FDI regulatory framework, the scope of the FDI control mechanism, the corresponding authorization process, and the sanctions applicable in the event of non-compliance.

## 1. THE REGULATORY FRAMEWORK AS RECENTLY REINFORCED

In December 2019, France adopted a decree (the "Decree") and an order (the "Order")<sup>2</sup>, both with the same effective date of April 1, 2020, to reinforce its FDI authorization process (the "FDI Reform").

Previously, in May 2019, the law known as "Loi PACTE"<sup>3</sup> had strengthened the sanctions available in the event of non-compliance with the FDI regulations, notably by reinforcing the Minister of Economy's ("MOE") power to issue injunctions.

Supplementing France's national legislation, a March 2019 EU Foreign Direct Investment Screening Regulation<sup>4</sup> (the "FDI Screening Regulation"), which will be applicable as of October 11, 2020, establishes a framework for the screening of FDI by EU Member States, and allows the European Commission (the "EU Commission") to recommend specific actions to a Member State in connection with an FDI, and other Member States which may be impacted by that FDI, to request information and to provide comments.

However, the ultimate decision regarding an FDI remains at the level of the Member State in which the investment is to take place.

Mindful of the issues raised by the fragile state of many businesses due to the effects of the COVID-19 crisis, on March 25, 2020, the EU Commission published a "Guidance to Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation)" (the "EU Guidance").

In the EU Guidance, the EU Commission insists that EU Member States should take all necessary measures to protect strategic industries, and in particular industries which may be weakened by the COVID-19 crisis.

It urges Member States to make full use of their existing control mechanisms or to implement a control mechanism quickly.

## 2. THE FRENCH FDI CONTROL MECHANISM

France requires the prior authorization by the MOE for certain investments, depending on three criteria: the nationality of the investor, the nature of the investment, and the nature of the activity, which is the target of the investment, without regard to the amount of the investment itself.

### Nationality of the investor

Both foreign individuals and French citizens residing in a foreign country are subject to the FDI control mechanism.

Consistent with this, foreign entities, and entities governed by French law but controlled by either foreign entities or individuals that would be subject themselves to the authorization process are also covered by the control mechanism.<sup>5</sup>

Any person or entity that is part of the chain of control<sup>6</sup> of an investor is considered in turn as an investor, and may be subject to the authorization process provided the applicable conditions are met.

This means that even if the ultimate parent in the chain is French, if there is a foreign company anywhere in the chain of control, the foreign nationality criterion will be met.

To simplify the process, it is possible for any entity or person within the chain of control to file the required authorization request on behalf of all the entities in that chain.<sup>7</sup>

On April 3, 2020, in a decision of particular interest to private equity funds<sup>8</sup>, the French Council of State ("*Conseil d'Etat*"), the highest French administrative court, confirmed that the determination of the persons and entities subject to the authorization process is to be made solely at the level of an investment fund's general partners, and not at the level of the fund's investors, and that the only chain of control that needs to be reported and authorized is the chain of control that relates to the general partners.

This is consistent with a narrow reading of the Order on this point. As a result, for the purpose of the FDI authorization process, the nationality of the investment fund is based on the country that governs the general partner, regardless of the nationality of the investors.

### Nature of the investment

The Decree broadened the definition of investments requiring the prior authorization of the MOE.

All investments in the activities described below made by any person or entity subject to the authorization process, and which results in such person or entity taking control of a French entity or in the acquisition by such person or entity of a branch of activity of a French entity, in whole or in part, require an authorization from the MOE.

In addition, investments made by non-European investors<sup>9</sup> are also subject to the authorization process if the non-European investor would exceed, alone or in concert, directly or indirectly, an ownership threshold of 25% of the voting rights of the target. Before the effectiveness of the Decree, this ownership threshold was set at 33.33%.

With a view to protecting French key assets in the context of the economic crisis resulting from the COVID-19 pandemic, the MOE announced on April 29th that the 25% ownership will be further reduced temporarily to 10% for listed companies until December 31, 2020.<sup>10</sup>

The decree implementing this announcement has not yet been published, but this is expected to happen very shortly.

Intragroup investments are exempted from the authorization process, as are add-on investments to previously authorized ones that involved a change of control or the crossing of the ownership threshold, subject to certain conditions and exceptions.

### Nature of the activity

Historically, activities that fell within the screening process were those related to essential infrastructures, goods or services, such as energy and water supply, space-related operations, electronic communications networks and services, research, production or marketing activities relating

to arms, ammunition and explosive powders and substances, cryptology, and activities related to public health.<sup>11</sup>

The Order broadened the list of "sensitive" activities to include:

- production, transformation or distribution of agricultural products, when such products contribute to the national food supply security;
- editing, printing or distribution of press publications related to politics or general matters; and
- R&D activities relating to "critical technologies," such as cybersecurity, artificial intelligence, robotics, additives manufacturing, semiconductors, quantum technologies, and energy storage.

Further, by another government order, dated April 27, 2020, biotechnologies were added to the list, clearly with the goal of covering activities that may lead to the development of a COVID-19 vaccine, although biotechnologies cover a much broader scope.<sup>12</sup>

Prior to the FDI Reform, a shorter list of sensitive sectors applied to EU/EEA investors. There is no longer a distinction between such investors and investors from other countries, which will increase the number of instances where EU/EEA investors will need to seek an authorization.

## 3. THE AUTHORIZATION PROCESS

To start the process, the foreign investor must file a request with the MOE.

The MOE has 30 days to reply, and state whether the investment:

- (1) does not require a prior authorization;
- (2) is authorized; or
- (3) requires further analysis to determine if France's interests can be preserved by subjecting the investment to certain conditions.

In the absence of an answer within this 30-day time frame, the authorization is deemed to have been denied. Prior to the FDI Reform, a lack of response by the MOE within the then applicable two-month period was deemed to be an authorization for the investment.

As is the case in many jurisdictions, in France the 30-day period only starts running as of the date on which the MOE considers, at the MOE's sole discretion, that all the required information supporting the authorization request has been received.

Although the Order lists the information that must be submitted with the request, the MOE can always take the position that certain information was not provided in a

sufficiently complete form. Consequently, in practice, the length of the period is uncertain.

If the decision is that a further review is necessary, the MOE has 45 days from the date on which the foreign investor received the MOE's decision to give an answer. Here again, in the absence of an answer within this time frame, the authorization is deemed to have been denied.

If the MOE rejects the transaction, the reasons for the refusal must be stated in the answer to the foreign investor.

Separately, a company considering bringing in a foreign investor may file a preliminary request with the MOE to determine whether its activities fall within the list of sensitive activities.<sup>13</sup> The MOE must reply within two months. The preliminary request process may be used even at a time when no specific investment is contemplated.

This mechanism, a feature of the FDI Reform, is likely to be used in the preparatory phase of a sale process to provide a definitive view as to whether an authorization will be required based on the nature of the activities involved, so as to get a better sense of the probable overall timing of the transaction.

The Decree provides for a simplified process for an additional investment to be made by an investor which had been previously authorized to invest in excess of the 25% threshold in an entity, and which, as a result of the additional investment, will acquire control of the entity.

The additional investment must be presented ahead of time to the MOE, which then has 30 days to provide an answer. Unless the MOE objects, a new authorization is deemed granted at the end of this period.

The new timing of the French review process should allow the MOE to take into account any opinions or comments by the EU Commission and/or other Member States pursuant to Article 6 of the FDI Screening Regulation.<sup>14</sup>

Even though the opinion and comments are not binding on the MOE, they must be given "due consideration."

Regarding investments not subject to a screening process in the Member State where the foreign investment is made, the FDI Screening Regulation allows, as of October 11, 2020, the EU Commission to issue an opinion, and the other Member States to provide comments, concerning the investment, up to 15 months after the investment takes place, and this even for an investment made prior to the effectiveness of the FDI Screening Regulation.

The MOE may make the authorization subject to certain conditions aimed at protecting France's interests. For instance, the MOE may request that the strategic activities be spun off to a structure in which the foreign investor will not have any involvement.

#### 4. APPLICABLE SANCTIONS FOR NON-COMPLIANCE

All agreements that directly or indirectly carry out an FDI subject to prior authorization may be held null and void if the authorization was not obtained.

Since the FDI control mechanism is aimed at safeguarding the public interest, any interested party, whether a third party or even a party to the agreement, may request its annulment in court.

Separately, if an FDI is completed without the required authorization, the MOE is entitled to order the investor to comply with one or several of the following measures:

- (1) filing an authorization request;
- (2) reinstating the previous situation at its own expense; and/or
- (3) divesting certain assets or complying with other conditions.

The investor may be subject to a daily penalty payment until the investor complies with the MOE's requirements, in an amount of up to €50,000 or about \$56,000 per day.

If the protection of France's interests is or might be jeopardized by the FDI having been completed without an authorization, the MOE may take any interim measures the MOE deems necessary, such as suspending the investor's voting rights, or prohibiting or limiting dividend distributions to the investor.

When the MOE subjects the authorization to certain conditions, if the MOE considers that they have not been satisfied, it may withdraw the authorization, or order the investor to comply with the conditions or with new conditions within a specific time frame.

These measures may also be accompanied by the daily penalty referred to above.

In addition, in cases where an investment is made without a required prior authorization having been obtained, where it was obtained by fraud, where the conditions attached to the authorization are disregarded, or where the orders or provisional measures of the MOE are not complied with, the investor may be fined in an amount which may not exceed the highest of the following: twice the amount of the investment, 10% of the annual turnover (excluding tax) of the legal entity carrying out the sensitive activities, €5 million or about \$5.6 million for legal entities, and €1 million or about \$1.1 million for individuals.

Any failure to comply with the obligation to submit an FDI to the MOE for prior authorization may also trigger criminal liability with sanctions including up to five years' imprisonment (in the case of an individual) and a fine equal to twice "the amount of the offence," which is interpreted to mean twice the amount of the investment.

## CONCLUSION

The reinforced French control of FDI is undoubtedly in line with the worldwide trend towards an increased control by European governments of certain types of foreign investments, which has now been accelerated by the economic reality resulting from the COVID-19 crisis.

Strongly encouraged by the EU Commission and its call, via the EU Guidance, to Member States to ensure that they put in place appropriate measures to safeguard critical sectors from predatory investments, various EU countries have strengthened their FDI screening measures in the context of the COVID-19 crisis, including Spain, Italy, and Germany.

As we have seen, in the midst of the COVID-19 crisis, France has taken measures to specifically include biotechnologies in the list of sensitive activities subject to control. Also, the ownership threshold triggering the need to have an investment in a French listed company by a non-EU investor approved will almost certainly be lowered temporarily to 10% in the coming days.

This low threshold highlights the fact that control is no longer the only focus of scrutiny and that, when it comes to certain economic sectors, even a small minority investment may be refused.

Given the trend for further strengthening of the control measures, it is not impossible that this lower threshold ultimately will remain in place for a longer term.

Also given this trend, developments allowing for more flexibility for FDI (such as the decision of the French Council of State concerning investment funds) may be put into question in the future.

Investors contemplating an investment in France should therefore discuss this regulatory aspect with their advisors and may want to consider whether they or the target should make a preliminary query as to whether the activity of the target would be considered sensitive for purposes of the FDI regulations.

## Notes

<sup>1</sup> According to a survey recently conducted by Ernst & Young, France was the number one destination in 2019 in Europe for foreign investments. Callum Jones, "UK loses foreign investment crown to France after two decades at top", *The Times*, May 28, 2020 (available at: <https://bit.ly/3dMkWEw>).

<sup>2</sup> Décret n° 2019-1590 du 31 décembre 2019 relatif aux investissements étrangers en France [Decree No. 2019-1590 dated December 31, 2019 related to foreign investments in France], *Journal Officiel de la République Française* [J.O.] [Official Gazette of France], Jan. 1, 2020, texte n° 35; Arrêté du 31 décembre 2019 relatif aux investissements étrangers en France [Order related to foreign investments in France dated December 31, 2019], *Journal Officiel de la République Française* [J.O.] [Official Gazette of France], Jan. 1, 2020, texte n° 38.

<sup>3</sup> Loi n° 2019-486 du 22 Mai 2019 relative à la croissance et la transformation des entreprises [Law No. 2019-48 dated May 22, 2019, on

business growth and transformation], *Journal Officiel de la République Française* [J.O.] [Official Gazette of France], May 23, 2019, texte n° 2.

<sup>4</sup> Regulation (EU) 2029/452 of March 19, 2019, establishing a framework for the screening of foreign direct investments into the Union.

<sup>5</sup> Article R 151-1 of the French Monetary and Financial Code, added by Decree No. 2019-1590, *supra*.

<sup>6</sup> "Control" is defined by reference to Article L.233-3 of the French Commercial Code, or when no control has been established on the basis of that Article, by reference to Article L.430-1, III, of the same Code. According to Article L.233-3 of the French Commercial Code, a company is deemed to control another company when (i) it directly or indirectly holds a fraction of the capital giving it a majority of the voting rights at shareholders' meetings, (ii) it holds alone a majority of the voting rights in that company via a shareholders' agreement that is not contrary to the company's interests, (iii) it effectively determines the decisions taken at shareholders' meetings through the voting rights it holds, or (iv) it is a shareholder of that company and has the power to appoint or remove the majority of the members of that company's administrative, management or supervisory bodies. Under Article L.430-1, III of the French Commercial Code, control arises from rights, contracts or other means which confer, alone or in combination, the right to exercise control, alone or jointly, and taking into account the circumstances of fact or law, the possibility of exercising a decisive influence on the activity of a company, and in particular (i) rights of ownership or use of all or part of the assets of a company, or (ii) rights or contracts which confer a decisive influence on the composition, deliberations or decisions of the governing bodies of a company.

<sup>7</sup> Article R.151-5 of the French Monetary and Financial Code, added by Decree No. 2019-1590, *supra*.

<sup>8</sup> CE Ass., Apr. 3, 2020, No. 422580.

<sup>9</sup> A European investor is defined as (i) an individual who is a citizen of a Member State of the European Union or of a State that is party to the Agreement on the European Economic Area, which has concluded an administrative assistance agreement with France with a view to combating tax evasion and tax avoidance and who is domiciled in one of those States, or (ii) an entity when all the members of the chain of control are governed by the law of one of those States or are citizens of that State and domiciled there.

<sup>10</sup> DG Trésor, "Covid-19 | Update of the foreign direct investment screening procedure in France," French Treasury Department (Direction Générale du Trésor) (Apr. 30, 2020), available at: <https://bit.ly/2VvACG8>.

<sup>11</sup> Articles L.151-3 and R.151-3 of the French Monetary and Financial Code, added by Decree No. 2019-1590.

<sup>12</sup> For example, the Organization for Economic Co-operation and Development (OECD) defines "biotechnology" as the "application of science and technology to living organisms, as well as parts, products and models thereof, to alter living or non-living materials for the production of knowledge, goods and services." "Biotechnology, Single Definition," OECD (Nov. 2, 2001), available at <https://bit.ly/2BW83ud>.

<sup>13</sup> It is also possible for a potential investor to file such a preliminary request with the authorization of the target company.

<sup>14</sup> Under Article 6 of the Regulation, Member States must notify the Commission and the other Member States of any foreign investment in their territory undergoing screening. The Commission and the other Member States have 15 days to notify the Member State in which the screening is taking place of their intention to provide comments or issue an opinion. The comments and/or opinion must be addressed to the concerned Member State within 35 days following receipt of the initial notification. If the MOE is informed that the EU Commission and/or other Member States intend to provide comments or issue an opinion, the MOE must inform the investor within the first 30-day review process that the

investment requires further analysis. This will give the MOE an additional 45-day period to make a decision which takes into account the opinion of the EU Commission and the comments received from the other Member States.

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