

Growing Foreign Investment Scrutiny for Global Deals

M&A SPOTLIGHT

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Growing foreign investment scrutiny for global deals

A major shift in the world's advanced economies' foreign investment policy has significant implications for the mergers and acquisitions (M&A) world.

Growing scrutiny of overseas investment has been most notable from the United States, but other advanced economies have also tightened conditions under which they will allow foreign entities to take full or partial ownership of domestic businesses and operations. As a result, more nuanced regulatory strategies will be necessary to ensure deals are pushed over the line.

The United States, which has long maintained an open investment policy, has just enacted the Foreign Investment Risk Review Modernization Act (FIRRMA), designed to address evolving national security concerns.

Canada, Australia and Germany haven't been far behind in tightening foreign investment regulations, while the UK and European Union are also developing new regimes.

These new regulations focus on national security implications of investments, not the national interest or antitrust concerns of many pre-existing regimes.

Driving this new scrutiny are record levels of investment—mostly from Chinese sources—in the world's advanced economies, increased activity by state-owned enterprises and sovereign entities, as well as a focus on technology and infrastructure.

These developments reflect expanding concerns about national security vulnerabilities and, while China has been singled out in all but name, the new regulations will affect foreign investment from all regions.

The policy shifts have impacted deal making even in advance of implementation of the new regulations.

For example, in the United States in 2017, 240 deals were reviewed, up from 172 in 2016, with 20 deals reportedly blocked or abandoned compared to just five in 2016. In particular, two deals were formally blocked by US President Donald Trump upon recommendation by the Committee of Foreign Investment (CFIUS), a power that was sparingly invoked in the past: Singapore-based Broadcom's bid for Qualcomm and Chinese-backed Canyon Bridge's planned acquisition of US chip maker Lattice Semiconductor. (US President Barack Obama had also blocked a bid by China's Fujian Grand Chip Investment Fund for the US business of chip equipment maker Aixtron in December 2016, and intervened to force divestiture of an additional Chinese investment.)

So far in 2018, three deals have reportedly been blocked, all with Chinese investors: Unic Capital Mgt and China Integrated Circuit Industry Investment Fund's bid for US semiconductor company Xcerra; the merger of Hong Kong marcomms company BlueFocus and US technology company Cogint; and SDIC Fund Management Co.'s investment in Maxwell Technologies.

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United States

The FIRRMA fundamentals

Under pre-existing regulations, CFIUS has authority to review any transaction which could result in control of a US business by a "foreign person," although there was previously no mandatory prior approval requirement.

FIRRMA expands CFIUS's jurisdiction and mandates prior approvals (called "declarations") for certain foreign investments in businesses handling critical technology, critical infrastructure and sensitive personal data.

A "pilot program" imposing prior approval requirements on investments in certain US businesses which produce, design or test "critical technologies" will commence November 10, 2018. Parties that fail to file a required declaration can be given a civil monetary penalty up to the value of the transaction.

FIRRMA also makes a series of other changes that strengthens CFIUS's authority and authorizes the sharing of information on transactions with allied governments. Notification timelines have been marginally extended and filing fees will be required for notifications (but not declarations).

At the same time, the administration is initiating a related regulatory process of classifying and imposing licensing requirements on exports of "emerging and foundational technologies," a move that likely will affect a broad range of cross-border transactions, including outbound investments from the United States.

Which transactions will be impacted?

Given the level of overseas involvement in the US M&A market at present, the range of transactions impacted by the new regulations is broad.

They include:

01

Certain acquisitions involving foreign state-owned investors.

02

Certain minority investments by non-US investors in US businesses involving "critical technology" or "critical infrastructure," or those processing or storing personal data of US citizens.

03

Investment into US venture capital funds by foreign investors.

04

Acquisition or lease of certain types of US real estate by foreign entities.

And the rest



UK

There is no foreign investment screening mechanism at present under UK merger control, but proposals have been put forward for a standalone review of national security mergers.

They include expanding the voluntary regime to "call-in" transactions on national security grounds, and there is the potential application of rules to new projects, "proximate sites" and "bare assets."



Germany

Current regulations allow the German government to examine acquisitions of more than 25% of the voting rights of a German target company by a foreign investor.

However, the German government has recently blocked two transactions.

It vetoed the proposed acquisition of German machine tool manufacturer Leifeld Metal Spinning by a Chinese investor citing security reasons for its decision.

It also instructed the state-owned development bank KfW to buy a 20% stake of 50 Hertz (the German power grid operator) to prevent its takeover by the Chinese State Grid Corp.



France

At present France actively encourages foreign investment, but recent political developments signal that approach may be waning.

President Emmanuel Macron recently vowed to form a more protective Europe due to concern over Chinese acquisitions in the EU's strategic industries. This naturally extends to French companies.

In February 2018 the French government announced a possible extension of the list of sensitive sectors, including AI and data storage, as well as new flexible sanctions and a strengthening of the control of undertakings borne by investors.



European Union

Previously, there was no EU-wide screening for foreign direct investment, but new proposals have set out a framework for such a process where there are security or public order concerns.

It is a non-exhaustive list including critical infrastructure, critical technologies, security of supply of critical inputs (e.g., mining outputs) and access to or the ability to control sensitive information.



Australia

Australia has been geared toward foreign investment in the past, but a review of national security is likely to change that.

A former top security official has been appointed to head the investment review board, and is expected to more closely scrutinize the process. Additionally, there has been the removal of the exemption for private foreign investors acquiring an interest in critical infrastructure assets purchased from state and territory governments, and the investment review board has also established a Critical Infrastructure Centre (CIC).

In addition, measures have been put in place to simplify the foreign investment regulations, such as new the business exemption and increased notification thresholds for global transactions holding Australian interest.

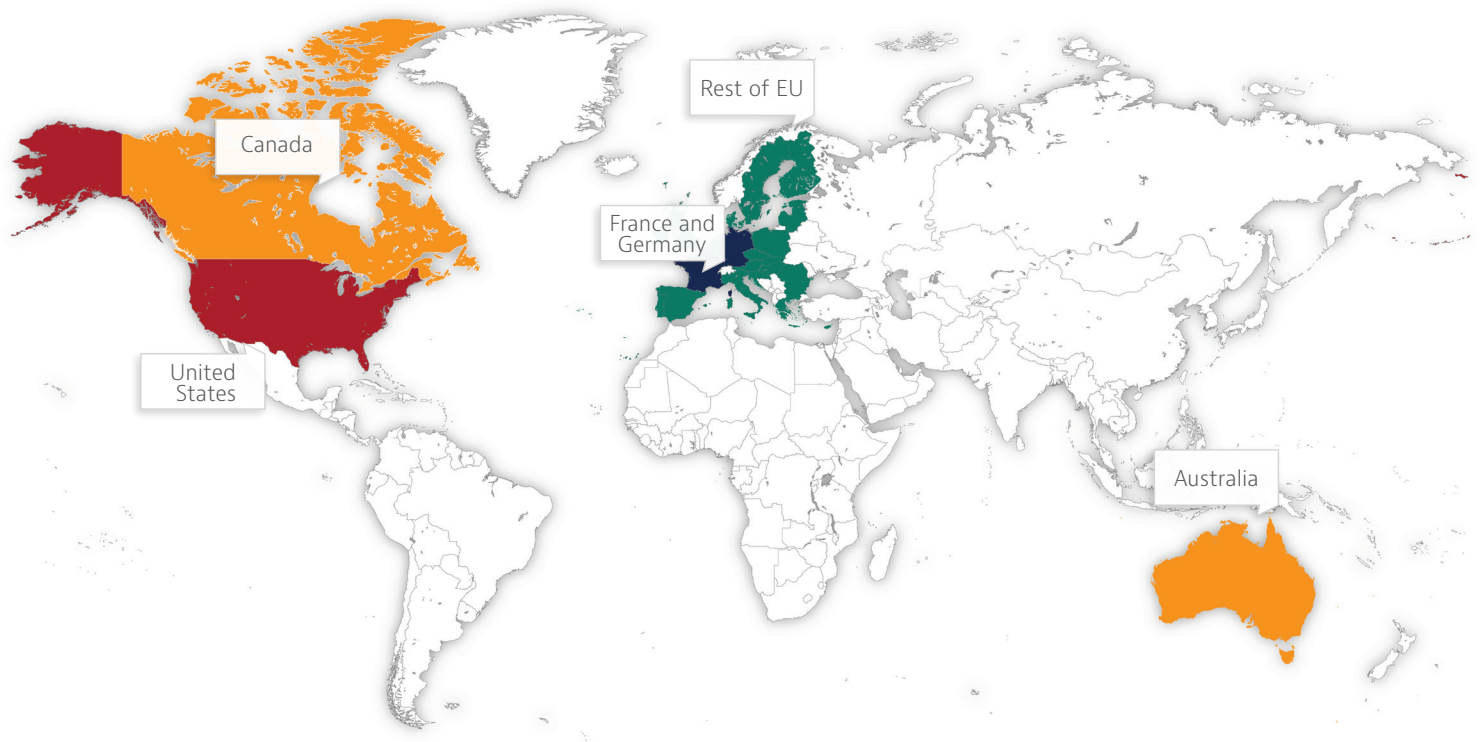


Canada

The Investment Canada Act allows the government to review any investment—including minority investments—which could be “injurious to national security,” but scrutiny looks set to tighten.

The “net benefit” review threshold has been increased for European and certain other Trade Agreement investors. Also, more scrutiny of certain transactions has taken place based on who the investor is and what they are buying, and the national security review risk has been heavily impacted by the political, economic and trade climate.

Countries reviewing their foreign investment laws



What can be done to mitigate deal risk?

Conduct an early risk assessment



Deal risk is highly dependent on the geography of the acquirer, so take a global view of national security risks



Craft a public and government relations strategy



Engage with the reviewing body early

Understand the process and timeline



Be prepared to make detailed disclosures

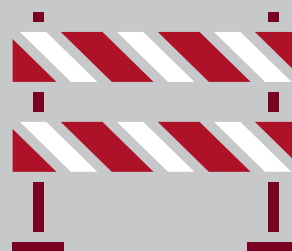
Consider deal terms to allocate risk and responsibility




Consider mitigation measures as part of transaction strategy



Don't forget about other regulatory hurdles





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