Private M&A 2021

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Getting The Deal Through

Davis Polk

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Published by
Law Business Research Ltd
Meridian House, 34-35 Farringdon Street
London, EC4A 4HL, UK

First published 2017
Fourth edition
ISBN 978-1-83862-386-9

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

Private M&A
2021

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Davis Polk & Wardwell LLP

Lexology Getting The Deal Through is delighted to publish the fourth edition of *Private M&A*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on the Dominican Republic, Georgia, New Zealand, South Korea, Thailand and Zambia.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Will Pearce and Louis L Goldberg of Davis Polk & Wardwell LLP, for their continued assistance with this volume.

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London
September 2020

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Foreign direct investment controls in cross-border acquisitions

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In addition to merger control and other regulatory approvals, an ever-growing number of jurisdictions have now adopted foreign direct investment (FDI) screening mechanisms. These aim to determine whether investments by foreign entities raise broader national security or other 'public interest' concerns.

In the United States, for more than 30 years, the Committee on Foreign Investment in the United States has been able to block acquisitions that threaten defence or other critical national interests. In recent years, similar regimes have proliferated across the world. The European Commission and UK government have signalled the need for strengthened powers. This spread of adoption, and increasing intensity, of FDI review, has been accelerating in the face of fears that the covid-19 pandemic will leave domestic businesses vulnerable to opportunistic foreign investors. The European Commission's response, having introduced an EU-level FDI screening framework due to come into effect on 11 October 2020, has been to urge the 14 member states that currently have FDI regimes to use these 'to the fullest extent'. This article will focus on the evolving landscape of FDI controls outside the United States.

FDI regime frameworks

As with merger control review, there is no 'one-size fits all' approach when looking at the different FDI regimes. Jurisdictions (particularly outside the EU) have taken divergent approaches in seeking to protect their own interests through a variety of mechanisms.

FDI screening regimes – being born out of public interest concerns – tend to confer a great deal of discretion on government authorities, enabling them to cherry-pick transactions of interest. One mechanism through which governments achieve this is through the use of broad, nebulous concepts to demarcate the sectoral scope of their regime. Concepts such as 'national defence', 'national security', 'critical infrastructure' and 'critical technology' are frequently utilised by authorities to afford them latitude in staking jurisdiction.

Sectoral coverage

One of the major variances between FDI regimes lies in their sectoral coverage. Most countries take a focused approach, identifying (albeit broadly) particularly sensitive sectors within which foreign investments may be subject to review. Typically, this will include categories such as national defence, critical infrastructure and critical technology, as well as other sectors politically sensitive to the particular jurisdiction. Certain other jurisdictions (including Australia, Canada and Germany) do not limit their review powers according to relevant sectors.

Transaction structure

A number of factors in the structure of the target and transaction may impact the obligation to notify. In Japan and India, for example, only direct acquisitions of an interest in a domestic company (with exceptions) are covered. Similarly, a filing can generally be excluded in jurisdictions where the target does not have subsidiaries, branches, offices or assets. One notable exception to this is the UK, whose FDI screening regime covers transactions where the target only has local revenues, without necessarily having a physical presence in the UK.

Another factor that drives the early FDI risk assessment is the level of control of the target company being acquired. In many jurisdictions, a transaction is not open to review if no control is being acquired or if the equity acquired is below a certain threshold (eg, 10 per cent in Spain, 25 per cent in France and 49 per cent in Mexico). Similarly to the merger control context, majority shareholding is, therefore, not a requisite to trigger most FDI screening thresholds and so minority investors must also consider FDI screening risks. Early consideration of these issues may, depending on the circumstances, allow the parties to adjust the transaction structure so as to avoid triggering FDI notification obligations.

Notification obligation

Under most FDI screening regimes, notification is mandatory and suspensory. As such, where there is a relevant transaction caught by such a regime, the parties must notify the relevant authority and may not close the transaction prior to receiving its clearance. Notable exceptions include Canada, which, for most transactions, imposes only a post-closing notification and the UK, which operates a voluntary notification regime while reserving the power to 'call in' any transaction where it deems there to be a public interest in doing so.

The consequences for failure to comply with an obligation to notify are typically severe. Penalties will often include a fine that, in India and Spain for example, can be as large as the entire transaction value. In addition, most regimes have the power to require the parties to unwind the transaction pending approval while certain others have the ability to impose criminal sanctions (for example, individuals responsible for a failure to notify in Australia may be imprisoned for up to three years).

Investor identity

Some investors' home states may be perceived as potentially more hostile to the host country than others. This will generally tend to affect the outcome of the screening, rather than determine which transactions are caught by the initial filing obligation. Nevertheless, certain FDI regimes do discriminate on the grounds of particular nationalities. For example, the FDI regimes of certain EU member states (including France, Germany and Spain) contain stricter rules for non-EU/EFTA investors. Similarly, India has expanded its regime to capture all indirect acquisitions of an Indian company by an investor located in a country that shares borders with India (in particular, China).

As such, filings can sometimes be excluded based on the type of acquirer. For instance, in individual EU member states, acquirers from elsewhere in the European Economic Area are regularly exempted from a filing requirement. Certain acquirers (eg, state-owned or Chinese investors) are more likely to trigger a foreign investment filing or face a higher substantive risk.

Timing implications

Given the suspensory nature of a number of FDI regimes, the relevant review period can have particularly acute timing implications for closing deals. For instance, the review process usually takes between four and six months in France, Germany and India. As a result of the covid-19 outbreak, some jurisdictions have planned for extended review periods (for instance, Australia has extended its review period from 30 calendar days to six months until the end of 2020). Such long lead times can extend far beyond other closing conditions (including merger control clearance in no-issues cases). It is, therefore, crucial that an FDI risk analysis is conducted ahead of negotiating conditions and termination rights in a transaction agreement.

Risk allocation

As described above, FDI screening raises the potential for prohibitively long review periods and the power of the relevant authorities to impose (substantial) remedies or prohibit or unwind transactions altogether where necessary. It is, therefore, crucial that parties give appropriate consideration to these risks from the outset and properly consider the allocation of risk in transaction agreements. Parties may increasingly desire deal protections such as a 'hell or high water' clause, obligating the buyer to proceed with the transaction regardless of any obligations imposed in connection with any regulatory approval, or reverse termination fees.

Information gathering

FDI filings generally require the parties to provide an extensive amount of (sensitive) information to the relevant authorities. In many jurisdictions, such as France and Germany, the statutory clock does not start until a complete notification has been received. Furthermore, where requests for additional information may have to be issued, certain jurisdictions, including France and Italy, have the ability to stop the clock of the review period until the requested information has been provided.

Most jurisdictions operate a clear separation between FDI screening and the merger control process. Although, therefore, there will be overlaps in the information required to make concurrent FDI and merger control filings in certain jurisdictions, there will be certain information specific to each and, therefore, an increased information gathering burden. However, in some jurisdictions (eg, Australia, Russia, China and – currently – the UK), FDI-related and merger control issues are assessed within the same framework. While there will be FDI-specific lines of questioning, this one-stop shop approach makes for a more streamlined dual-review process.

Particularly in light of the timing implications discussed above, expedient information-gathering and initiation of the review period can materially advance the transaction closing date.

Practice points

- FDI screening risk should be considered as early as possible in the deal-making process in order to inform both the structure of the investment and the negotiation of transaction documents.
- Given the extensive review period of many FDI regimes, it may be prudent to engage in information gathering ahead of signing to expedite the notification process so far as possible.
- Like merger control reviews, hefty fines and unwinding orders (as well as, in some cases, criminal sanctions) may be imposed if the parties fail to notify a transaction. The outcome of the FDI review may also result in remedies being imposed on the parties as a condition to clearance.

Legal developments

The increasingly expansive approach taken by governments in establishing jurisdiction to review transactions in recent years necessitates that dealmakers appropriately address this issue early in the deal process. This is particularly so in light of the wave of amendments made in response to covid-19, as well as the dawn of the EU's FDI framework.

Recent reforms

A number of G20 jurisdictions had taken steps to tighten FDI controls before, and entirely unrelated to, the pandemic. Although it was mainly in the pipeline prior to the pandemic, Germany is in the process of adopting a third legislative amendment to its FDI regime this year. So far, these reforms have focused on expanding the list of sectors, including artificial intelligence, biotech and semi-conductors, with a lowered shareholding threshold for triggering a mandatory filing from 25 per cent to 10 per cent. Significantly, the standard of review has been lowered, requiring only that the foreign investment is 'likely', rather than an 'actual threat', to affect security or public order in Germany. The regime has been further tightened by the imposition of a standstill obligation for any notifiable transaction, subject to criminal penalties (including imprisonment) for breach. The third amendment is anticipated to further extend notification obligations and the sectors subject to the lower 10 per cent control threshold.

In the UK, a stand-alone regime is expected to be implemented later this year under the National Security and Investment Bill. This will replace the current framework, which is tied to UK merger control review. It is expected that this regime will retain the voluntary nature of notifications currently employed and that the regime will apply to investments in companies in all sectors (with no turnover or control threshold) where there may be national security concerns. To guide parties, it has been indicated that 'core areas', deemed particularly likely to raise national security concerns, will be identified.

Similarly, the French government passed a Decree on 31 December 2019 amending its FDI regime. This, most notably, expanded the list of sensitive sectors to include critical technologies, the print and digital press and food safety. These examples, in addition to the upcoming EU framework discussed below, highlight the fact that tightening FDI controls was on the agenda even before the dramatic effects of covid-19.

Rapid responses to the covid-19 pandemic

Amid global trends of growing populism, the covid-19 pandemic has so far proven a catalyst for the adoption of heightened protectionist policy through FDI controls. Faced with a sudden drop in asset values, governments across the world have sought means to protect their domestic businesses from potentially predatory foreign investments. In combatting this perceived threat, FDI controls have become a popular tool for many governments.

The response by many governments has been as swift as it has been dramatic. In Australia, for example (an FDI screening regime with no sectoral limits), a temporary measure has been put in place such that no monetary threshold need be met for an acquisition of Australian shares or assets to be notifiable. Spain, a jurisdiction with a historically light-touch FDI regime, has enacted emergency regulations that impose significant regulatory tightening focused on non-EU/EFTA investors and, in particular, those owned or controlled by a foreign government. This focus on ex-European or government-controlled investors, or both, is seen by many as being particularly targeted at Chinese investors. Similar sentiment is believed to have motivated the Indian government

to tighten its rules such that any acquisition of an Indian company by an investor located in a country that shares borders with India (which includes China) is subject to approval.

Even in jurisdictions undergoing broader, pre-pandemic initiated reforms, short-term responses have been adopted to protect particular interests. In the UK, in addition to the broader reform anticipated under the National Security and Investment Bill later this year, the government added 'the capability to combat and mitigate the effects of public health emergencies' as a public interest ground for intervention. The government's guidance issued with respect to this amendment indicated the breadth of this ground, stating that it might capture an internet service provider or food supply chain company, given the significance of these services in a pandemic-induced lockdown situation. In Germany, while expanding the sectors subject to a lower 10 per cent shareholding mandatory filing threshold, personal protective equipment, pharmaceutical essentials and certain medical devices, including IV diagnostic devices, were included.

The rapid reactions of governments across the globe evidence just how quickly and dramatically FDI controls can evolve. While responses have diverged in their approach, the thrust in all cases has very much been a desire to claim jurisdiction to protect domestic businesses at the expense of foreign investors. Although legislative activity has slowed, the momentum is continuing in the direction of protectionism through greater government intervention in acquisitions.

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EU seeks to harmonise European FDI review

On 19 March 2019, the Council of the European Union adopted Regulation (EU) 2019/452 (Regulation), to create an EU-wide framework for screening FDI. This seeks to ensure EU-wide coordination and cooperation on the screening of FDI likely to affect security or public order, but stops short of the European Commission's (EC) one-stop shop approach to merger control within the EU. Under the EU FDI framework, the EC itself will not have any direct powers to interfere with transactions. Instead, it has two tracks of review powers under which it may issue an opinion.

The first opinion-making power applies where there is proposed FDI into the EU that is (1) likely to affect projects of 'Union interest' and (2) is reviewable on the basis of security and public order. Here, the EC may itself review the proposed investment and issue an opinion. The EC's opinions do not, themselves, carry any legal consequence. However, any member state that reviews the relevant FDI must take 'utmost account' of the EC's opinion and provide an explanation to the EC if its opinion is not followed. Transactions of Union interest are expected to include projects that enjoy substantial EU funding or are covered by EU legislation 'regarding critical infrastructure, critical technologies or critical inputs', such as research (Horizon 2020), space (Galileo), transport (the Trans-European Networks for Transport), energy (TEN-E) and telecommunications.

The EC's secondary opinion-making power applies where an investment does not meet either of the limbs in the preceding paragraph, but is subject to FDI screening by a member state. In such circumstances, the member state must inform the EC and other member states 'as soon as possible' following commencement of the review. The EC and other member states may each issue an opinion on the investment, and the reviewing member state must give 'due consideration' to any such opinions received in its review of the particular investment.

Aside from establishing this collaborative, approach to FDI reviews, the Regulation also establishes reporting requirements. Each member state, regardless of whether it has implemented an FDI screening regime, must produce an annual report of all FDI that took place in their territory over that time. The EC will then produce an annual report on the implementation of the Regulation, which will be made publicly available.

It remains to be seen in practice how much discretion will be afforded to reviewing member states departing from opinions handed down under either standard. Given the political nature of FDI review, it is likely, however, that this dual review process will raise tensions and not be without conflict between reviewing member states, their fellow member states and the EC.

Closing remarks

The recent rapid and sweeping reforms of FDI controls in many key jurisdictions have required an increasing focus by dealmakers on this issue. The flurry of protectionist legislative measures taken, in part in response to the sharp fall in asset values in reaction to the covid-19 crisis, has jump-started the move towards ever-more prohibitive FDI regimes. While such swift and aggressive adoption of heightened protections is likely to slow, many expect that the momentum will continue in this direction in the coming years.

The ever-growing scope of governments' jurisdiction to review, together with the potential sanctions and remedial action that can be imposed on parties that fail to comply, necessitates engagement with potential FDI issues early in the transaction process. However, prudent attention to this regulatory issue can minimise the negative timing and risk implications now faced in cross-border transactions.

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ISBN 978-1-83862-386-9