Foreign Direct Investment (FDI) Screening – Filings in a Time of Crisis

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In addition to antitrust and other regulatory approvals, an increasing number of jurisdictions have now adopted 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 thirty years, the Committee on Foreign Investment in the United States (**CFIUS**) has been able to block acquisitions that threaten defense or other critical national interests.[1] This briefing looks at the recent wider spread of similar regimes - now accelerating as a result of fears that the present COVID-19 pandemic will leave domestic businesses vulnerable to opportunistic foreign investors.

FDI screening outside the US varies by jurisdiction, but bear in mind that:

- ***It's not just about defense:*** In some countries, the FDI screening only applies to certain sectors (e.g., France, Italy and Japan) while others catch all economic sectors (e.g., Australia, Canada and China). Germany operates two FDI screening regimes in parallel: one applies to all sectors while the other is specific to defense;
- ***It's not about specific nationalities:*** Some investors' home states may be perceived as potentially more threatening to the host country than others. But this will generally tend to affect the outcome of the screening, rather than determine which transactions are caught by the initial filing obligation. Nevertheless, the FDI regimes of certain EU Member States (e.g. France, Germany and Spain) contain stricter rules for non-EU/EFTA investors;
- ***Investors will usually need to be proactive in seeking clearance:*** In most countries operating an FDI regime, filing is mandatory. Most of the mandatory jurisdictions are suspensory: the relevant authority's approval has to be obtained prior to closing. Other countries, such as the UK, leave it to the parties to decide whether to notify (although with the risk of the transaction being "called-in" by the relevant authority);
- ***The process will often trigger an additional regulatory workstream:*** Most jurisdictions operate a clear separation between FDI screening and the antitrust merger control process. However, in some jurisdictions (e.g. Australia, Russia, China and - currently - the UK), FDI-related and antitrust issues are assessed within the same framework;
- ***FDI screening rules are often very broadly drafted:*** Much discretion is frequently left to governments, enabling them to "cherry-pick" transactions of interest. For instance, many jurisdictions do not define key concepts (such as, "national defense", "key infrastructures", "media", etc.) and/or have open-ended provisions; and

[1] Resource materials prepared by our lawyers are regularly published on our **website**. These include contributions on recent changes to CFIUS rules ("CFIUS Issues Final FIRM Regulations", January 2020, available **here**; "CFIUS Issues Proposed FIRMA Regulations", September 2019, available **here**).

- ***The FDI landscape is swiftly evolving:*** Quite apart from the introduction of new, protective regimes, the filing thresholds and review periods under existing regulations are in constant flux as countries respond to pandemic and broader economic concerns.[2] Even before the pandemic, each of the European Commission (**EC**), the UK government and the Japanese government had signaled the need for strengthened powers. An EU-level FDI screening regime is due to come into full effect on October 11, 2020[3] and the European Commission is urging the 14 EU Member States[4] that currently have FDI regimes to use these "to the fullest extent" during the current crisis.

Practical considerations

If FDI filing(s) are required for a transaction, note that:

- ***Sanctions can be severe:*** A failure to notify (when mandatory) is generally subject to penalties, including heavy fines, unwinding orders and/or criminal sanctions (which, in some cases, may be imposed on individuals and/or companies). For example, under Australian FDI rules, individuals may be imprisoned for up to 3 years; new Spanish FDI rules include the imposition of a fine of up to the transaction's value for failure to notify.
- ***Timelines can be lengthy:*** Given that many regimes are suspensory, the timing of deals may be significantly impacted. For instance, the review process usually takes between 4 to 6 months in France, Germany and India. As a result of the COVID-19 crisis, some jurisdictions have temporarily decided not to accept new notifications (e.g., Italy, until May 15)[5] or to extend their statutory review period (e.g., Australia, from 30 days to 6 months).
- ***Risk needs to be allocated:*** Relevant authorities usually have the ability to impose (substantial) remedies or prohibit/unwind transactions when necessary. In critical cases, the parties should therefore carefully consider allocating risks in transaction agreements ("hell or high water", reverse termination fees, etc.).
- ***Information gathering can be onerous:*** FDI filings generally require the parties to provide an extensive amount of (sensitive) information to the relevant authorities. Requests for additional information may also be issued and, in certain jurisdictions (e.g. Italy), these can stop the clock of the review period until the requested information is provided.
- ***Outcomes are uncertain:*** FDI screening regimes are more unpredictable than merger control reviews, with broader discretionary governmental powers and less transparency in decisions and precedents. They are also subject to rapid changes (e.g., recent COVID-19 reforms).

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[2] For instance, in response to the COVID 19 crisis, Australia has temporarily removed monetary thresholds that usually apply in determining whether a FDI filing is required for transactions signed after March 29, 2020.

[3] In contrast with CFIUS in the United States, the EU FDI Regulation does not introduce a centralized EU-wide screening mechanism for FDI. Instead, it establishes a cooperation mechanism between the EC and the EU Member States and gives the ability to the EC to issue opinions whenever a transaction is likely to affect EU interests. A full version of the Regulation is available **here**.

[4] Namely Austria, Denmark, Finland, France, Germany, Italy, Latvia, Lithuania, Hungary, the Netherlands, Poland, Portugal, Romania, Spain (and UK).

[5] In practice, this means that a transaction requiring approval from the Italian government will need to suspend closing until such approval is granted (i.e., there is no exemption available to the mandatory and suspensory Italian FDI regime during the blackout period). A failure to notify may be subject to heavy fines and/or unwinding orders from the Italian government.

But it's not all bad news…

Filings can be ruled out for a large number of jurisdictions based on very limited information - in particular:

- ***Transaction structure:*** In several jurisdictions, a filing can be excluded where the legal entity being acquired is located in another country (indirect acquisitions are not caught in Japan and India (with exceptions)) or where the investment is below a certain equity threshold (10% in Germany or 25% in France when "control" is not being acquired).
- ***Type of acquirer:*** In various countries, a filing can be excluded based on the type of acquirer. Thus, in individual EU Member States, acquirers from elsewhere in the EEA are regularly exempted from a filing requirement. Certain acquirers (e.g., state-owned or Chinese investors) are more likely to trigger a foreign investment filing and/or face a higher substantive risk.
- ***Target's geographic presence:*** A filing can generally be excluded in jurisdictions where the target does not have subsidiaries, branches, offices or assets. Exceptions to this rule include the UK, whose FDI screening regime covers transactions where the target only has local revenues.
- ***Target's activities:*** As noted above, certain FDI screening regimes only apply to certain sectors (e.g. national defense, critical infrastructures, critical technologies) though others apply across the whole economy.

In a rapidly changing regulatory landscape, deal teams are encouraged to focus on potential FDI filings at a very early stage, to mitigate adverse timing and other execution risks. Knowing and planning for these risks from the outset increases the chances that a review can be avoided or that its burdens can be minimized.

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