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Impact of COVID-19 on Global Foreign Direct Investment Screening Mechanisms

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Governments across the globe have been tightening up efforts to screen foreign investments by implementing legislation to protect their own national interests and economies. This has become ever more apparent during the COVID-19 pandemic due to the concerns that the economic impact will lead to an undervaluation of critical national assets and the sale of such assets to foreign investors. As a result, the scope of mandatory notifications has been expanded to include the acquisition of companies in critical technologies. International investors should therefore bear in mind that transactions involving the acquisition of national companies or assets in strategic industries (such as the healthcare sector) may raise scrutiny on national security grounds and be prepared to take these national rules into account when planning acquisitions.

Below we highlight some of the foreign screening mechanisms in place in the EU, UK and the US and the responses taken by national governments in light of COVID-19.

European Commission

The European Commission is and remains open to foreign investment. However, it recognises that one of the consequences of COVID-19 is an *"increased potential risk to strategic industries, in particular but by no means limited to, healthcare-related industries."* Indeed, the Internal Market Commissioner, Thierry Breton, has declared before the European Parliament Transport and Tourism Committee that these strategic sectors should be protected from *"aggressive investment strategies from non-European companies that are trying to take advantage of the crisis to get a few extra European jewels in their crown."*

At present, there is no "one-stop-shop" in the EU for screening foreign direct investment (FDI) as exists for merger control. In March 2019, a new FDI regulation establishing a framework for screening of FDIs into the EU on the grounds of security or public order was adopted. The regulation does not seek to harmonise screening tools across the EU, but introduces coordination and information mechanisms between Member States and the Commission.

The new FDI regulation is due to apply fully as of 11 October 2020. In the meantime, Trade Commissioner Phil Hogan invited Member States on 16 April 2020 to "informally" cooperate with the Commission by activating in advance the information exchange tools in the new FDI regulation in order to better deal with predatory takeovers of key European companies. The Commission has also published guidance to all Member States, calling upon them to:

- Make full use of their FDI screening tools now to take fully into account the risks to critical health infrastructures, supply of critical inputs and other critical sectors; and
- For those without a screening mechanism or whose mechanisms do not cover all relevant transactions, to set up a fully-fledged screening mechanism and use "all other available options" in the meantime to ensure no risk to security or public order in the EU.

A Commission White Paper on Foreign Subsidies is expected to be published next week. This will tighten the rules for foreign state-owned and state-backed enterprises buying EU companies to prevent the use of unfair subsidies. These powers are planned to limit competitive imbalances and to provide a level playing field.

At the time of writing, FDI screening in the EU remains national and subject to each Member State's interpretation, National screening mechanisms are already in force in 14 of the 27 Member States. Below we outline the mechanisms in place in some EU jurisdictions which shows the diversity of interpretations and approaches across the EU.

Germany

Under the current regime, the German government may review acquisitions of at least 25% of the voting rights of a German company by a non-EU entity on national security or public order grounds. For certain sectors, such as critical infrastructure and defence, the threshold is lower, at 10% of the voting rights. Following the COVID-19 outbreak, the German government has put forward draft legislation, currently under parliamentary discussion, to expand the scope of the FDI screening mechanism to provide additional protection to the healthcare industry. In particular, the new measures would harmonize the review standard in accordance with the EU's FDI regulation, changing the criterion from whether an acquisition poses *"an actual and grave threat"* to public order or national security to whether an acquisition is *"likely to affect"* public order or security. It also extends the 10% voting rights threshold to investments concerning critical technology, such as personal protective equipment, in-vitro diagnostics and medicinal products essential for the guarantee of preventive healthcare.

Italy

In Italy, prior to COVID-19, the FDI screening mechanism in place enabled the government to intervene on a wide range of corporate transactions (including mergers/de-mergers, branch transfers, etc.) in order to protect strategic interests. Government approval was required for transactions regarding the defence and national security sector (for both EU and non-EU investors) and in relation to specific assets in the fields of 5G technology, energy, transport and telecommunications (for non-EU investors only). Following the outbreak of COVID-19, the scope of government powers in Italy have been expanded, amongst other things, to: (i) include new sectors, i.e. critical infrastructures (such as banking, data processing, healthcare and insurance), critical technologies (such as biotech and cybersecurity) and critical input (such as food supply and safety); (ii) increase the type of operations requiring government approval (until 31 December 2020) for both EU investors (in respect of operations involving the acquisition of control) and non-EU investors (where the minimum threshold is the acquisition of a 10% shareholding in an investment of at least EUR 1 million); and (iii) enhance disclosure obligations before the Italian market regulator for share acquisitions in listed companies.

Spain

In Spain, prior to the COVID-19 outbreak, the FDI screening regime concerned only foreign investments related to national defence. In March 2020, the government extended the screening mechanism by requiring non-EU undertakings to notify transactions leading to the acquisition of at least 10% shareholding, or the exercise of effective participation in the control of a Spanish company in the sectors of critical infrastructure (for instance, energy, transport or communication); critical technology and dual use (for instance, nuclear technology, artificial intelligence, robotics or semiconductors); supply of critical inputs (energy or food supply); media; and sensitive information related industries. Violation of the notification obligation may result in fines as well as making the transaction null and void.

France

Prior to COVID-19, the FDI screening mechanism in France required foreign investors (both EU and non-EU) to seek government authorization in the case of an FDI in a sensitive business sector. It covered approximately 30 sectors, ranging from the defence to energy and communication to artificial intelligence, robotics, and semiconductors. Following the COVID-19 outbreak, the French government added biotechnologies to the list of strategic industries and announced that it would lower the threshold triggering the screening mechanism for share investments in listed companies operating in strategic sectors for non-EU investors to 10%. The measure is expected to enter into force in the second half of 2020 and will remain applicable up until 31 December 2020.

UK

In the UK, there is no direct screening mechanism of foreign investments but the government can intervene in transactions on "public interest" – including national security – grounds under the Enterprise Act 2002. In June 2018, the powers of the government to intervene in mergers were expanded to include transactions in the military and dual-use, computing hardware and quantum technology sectors in the UK by reducing the merger thresholds for transactions in these sectors.

On 24 July 2018, the UK government published a White Paper and a draft Statutory Statement of Policy Intent setting out a proposed "longer-term" reform of the national security regime. The proposals build on a green paper published in October 2017 and proposed a significant increase in the government's powers to scrutinize investments on national security grounds, including through the creation of an entirely new regime for reviewing transactions that would extend to all sectors of the economy and apply to a much wider range of transactions. Under the proposals, the government must have a "*reasonable suspicion*" that a transaction may pose a risk to national security before it can launch an investigation. Unlike the current regime, there would be no need for the transaction to reach a particular turnover or share of supply threshold. There would be no mandatory filing requirement, although parties would be encouraged to make voluntary notifications to the government if they believed a transaction might raise national security concerns.

The government has made repeated commitments to legislate for the implementation of the proposed reforms, most recently in the December 2019 Queen's Speech, where it set out the framework of a new National Security and Investment Bill and underlined its intention to upgrade its existing powers to *"scrutinize investments and consider the risks that can arise from hostile parties acquiring ownership of, or control over, businesses or other entities and assets that have national security implications."* In the meantime, the UK Parliamentary Foreign Affairs Committee has opened an inquiry into the role of the Foreign and Commonwealth Office (FCO) in blocking foreign asset stripping of UK companies, especially where there may be national security risks. At the time of writing, it appears the UK government is considering making it mandatory for British companies to report attempted foreign takeovers that could lead to security risks. Such a duty would be backed by criminal sanctions. This goes significantly further than the White Paper, under which companies would have been expected to make voluntary notifications.

United States

In the US, the Committee on Foreign Investment in the United States (CFIUS) is charged with responsibility for reviewing foreign acquisitions of and investments in US businesses for potential national security concerns. Where CFIUS identifies a national security issue with a contemplated or completed foreign investment transaction, it is authorized to mitigate those issues by modifying, prohibiting, or even unwinding the transaction in question.

While the US government has not introduced legislation, regulation or policies specifically to address issues related to COVID-19, recent national security reforms have expanded the jurisdictional reach of CFIUS to reach a broader range of foreign investment transactions, including those with a potential nexus to the United States' ability to respond to the pandemic. For example, whereas in the past, CFIUS was authorized to review only transactions that could result in a foreign investor gaining "control" of a US business, new legislation from 2018 and implementing regulations now authorize CFIUS to review non-controlling, non-passive investments in certain categories of US businesses.

With respect to the types of target companies that may touch on COVID-19 issues, CFIUS now has jurisdiction to review and mitigate foreign investments in US businesses that deal in *"critical technologies"* and that maintain or collect *"sensitive personal data"*. With respect to critical technologies, certain companies in the biotechnology and therapeutics industries may find their financings subject to CFIUS jurisdiction if they develop or test certain precursor chemicals, or human, animal, or plant pathogens or toxins. With respect to sensitive personal data, companies that work with genetic data or clinical test results may find their financing transactions subject to CFIUS review.

The CFIUS regulatory landscape continues to evolve. On May 6, 2020, the US Department of the Treasury issued new proposed rules again transforming the way CFIUS will determine whether it has jurisdiction to review certain foreign investments in US businesses. US companies and foreign investors alike must take note of these changes.

Implications for investors

At the moment, FDI screening mechanisms have been expanded in all major jurisdictions, particularly in response to COVID-19. Given the wide range of foreign screening tools in place, and different languages and interpretations, international investors are advised to take these into account as part of their planning process in their deal documentation, as it will undoubtedly impact on timings and the outcome of a transaction. Investors are reminded to approach authorities as early as possible to avoid any administrative hiccups and circumvention of the rules.

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