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COVID-19: Impact on Governmental Foreign Investment Screening

Share

COVID-19 continues to wreak havoc with the global economy, disrupting all manner of business throughout the world. Stock markets have plummeted and many companies are having to grapple with the economic damage. There is a great deal of uncertainty in the transactional space, with many potential investors taking a cautious approach before committing to significant transactions.

However, this unprecedented environment could afford opportunistic buyers the chance to acquire or invest in companies that have been weakened by the crisis. In addition, creditors may unintentionally find themselves in a position where they acquire control over a business. Assuming control or ownership upon default may well be a triggering event for foreign investment regulatory authorities where the creditor (new owner) is ultimately foreign owned, such as in the United States.

Pre-COVID-19, as the world de-globalised, rising national protectionism had been driving calls for stronger screening of foreign investment across the globe.

Now, COVID-19 has prompted some countries to take an even more stringent approach: Some national governments, notably in Europe, are now taking steps to protect companies which have become vulnerable as their economies are struggling from being taken over by foreign investors. Thierry Breton, the EU Commissioner for Internal Market and Services, has commented that the pandemic could mean that Europe needs to re-think its industrial policy in the "post-globalisation era", and that now may be the time to take into account things like being too dependent on one country, one region, or one company[1]. On 25 March, the European Commission ("Commission") published guidelines to EU Member States[2] , calling on them to adopt or strenuously enforce their foreign investment screening mechanisms to protect sensitive assets from foreign takeover during the crisis.

Whilst European countries were the first to announce more restrictive foreign investment screening in response to COVID-19, other jurisdictions, such as Australia, are beginning to follow suit.

These developments highlight the need for investors to carefully consider foreign investment review risks at this highly sensitive and volatile time in respect of both deals which are currently underway and transactions being contemplated. While most cross-border transactions have a high likelihood of being approved, those in strategic sectors may encounter more scrutiny and face a prolonged approval process. Taking the time to understand the rules and identify a regulatory strategy, including appropriate messaging and communication with the relevant governmental authorities, and the consequential impact on deal documentation (such as whether any closing condition is required), early in the deal process can minimize the risk of delays, last-minute changes to the deal structure, or even failed transactions.

Some examples where countries are taking a more stringent approach toward foreign investment are set out below:

EU

On 25 March 2020, the Commission issued new guidance on foreign investment screening in response to the current health and economic crisis. The aim is to preserve EU companies and critical assets, notably in areas such as health, medical research, biotechnology and infrastructures that are essential for security and public order, without undermining the EU's general openness to foreign investment.

The Commission calls upon Member States that already have an existing screening mechanism in place to make full use of tools available to them under EU and national law to prevent capital flows from non-EU countries that could undermine Europe's security or public order. The Commission also calls on the remaining Member States to set up a fully-fledged screening mechanism and in the meantime to consider all options, in compliance with EU law and international obligations, to address potential cases where the acquisition or control by a foreign investor of a particular business, infrastructure or technology would create a risk to security or public order in the EU.

There is no EU-wide foreign investment screening mechanism at present, and no plans to introduce one. The current EU foreign investment screening regulation, which takes effect in October 2020, creates a cooperation mechanism in relation to foreign investment into the EU but does not give the Commission the power to block foreign investment (for further details see our previous client alert). The latest guidance does not introduce any new laws or powers in relation to foreign investment screening, either at EU or Member State level. However the message is clear: Member States should use whatever powers they have to protect strategic assets and technologies from foreign takeover at this critical time. Whilst the guidance focuses on the healthcare sector, with references to medical and protective equipment, and development of vaccines, it is important to remember that the EU foreign investment screening regulation and this latest guidance are not restricted to the healthcare sector and apply to all sectors.

This latest move by the Commission, along with measures already announced by some Member States (see below), are likely to be the start of a more restrictive approach to foreign investment review in Europe in the coming months, in response to the pandemic.

Spain

The Spanish government has responded to the health crisis and highly volatile financial markets by introducing a new temporary requirement that ex-ante approval will be required for foreign (non-EU) direct investments in strategic sectors in Spain[3]. This measure is designed to protect Spanish companies economically affected by COVID-19 from foreign investors and will remain in place until the Spanish government decides to withdraw it.

The measure amends the existing foreign investment regime and affects investments in Spanish companies by non-EU/EFTA entities where the foreign investor would (i) hold a stake of 10% or more in the share capital of (ii) acquire the right to participate in the management of or (iii) acquire control of a Spanish company. Such investments will be subject to ex-ante authorization in a broad range of sectors, namely:

- Energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure and sensitive facilities;
- Critical technologies and dual-use items, including artificial intelligence, robotics, semiconductors, cyber-security, aerospace, defence, energy storage, quantum and nuclear technologies, as well as nanotechnologies and biotechnologies;
- Supply of key inputs, in particular energy, raw materials and food security; and,
- Sectors with access to sensitive information, in particular personal data, or with the ability to control such information.

Additionally, an ex-ante authorization will also be required for foreign direct investments where:

- The foreign investor is directly or indirectly controlled by the government, including public bodies or the armed forces, of a third country;
- The foreign investor has already made investments or participated in business sectors affecting security, public order and public health in another EU Member State; and
- Proceedings, either administrative or judicial, have been opened against the foreign investor in another EU Member State or in its home State or in a third State for criminal or illegal activities.

Failure to comply with the ex-ante authorization regime will mean that the foreign direct investment will not be legally valid and could be subject to administrative penalties.

France

The French government has also announced its intention to protect national companies from the threat of foreign takeover during this crisis. The French foreign investment review regime had already been significantly strengthened very recently, with new laws to widen the scope of investments covered by the regime, and requirements to provide substantial information in order to receive approval. This new regime will take effect from 1 April 2020.

There have been no specific changes yet to the French regime as a direct result of COVID-19 (unlike in Spain). However, the French Minister of Economy has stated that the government is ready to protect important French companies by recapitalising them, buying shares or even taking them over. The government announced a series of measures in favour of French companies (notably, a EUR 300 billion plan (validated by the EU) to guarantee bank loans, postpone tax and social security payments and finance the cost of partial unemployment).

The government has also specifically stated that nationalisation of strategic companies will not be ruled out if necessary. The French State has the power to nationalise a French company if it meets a public interest objective.

No specific nationalisation is officially contemplated at this stage but it is possible that companies in strategic sectors, such as the automotive and aircraft industries, may seek support from the government, as they are directly and heavily affected by the pandemic.

Italy

Italy is also contemplating introducing measures to protect companies in strategically important sectors. The Italian government is considering possible amendments to the current Italian rules on foreign investment screening (so-called "Special Powers" of the Italian Prime Minister). The Prime Minister and the government are looking at the possibility of qualifying all Italian companies listed on the Milan Stock Exchange – including banks and financial institutions – as "strategic" for the purposes of the application of the existing Special Powers rules.

If this happens, this could mean that the current Special Powers rules on foreign investment, which currently allow the Prime Minister to veto or impose conditions in relation to certain transactions in the defence/homeland security, telecoms, energy, and transportation sectors, could be extended to foreign investment in all Italian listed entities.

Germany

In light of the COVID-19 crisis, the German government would likely restrict the acquisition of medical companies by non-EU or EFTA entities. Different to before the crisis, even the sale of a small to medium sized medical company could presumably be considered to endanger the public order and security of Germany. While many have expressed concerns that foreign investors may be acquiring German companies and have called for stronger screening of foreign investments, the German government has not indicated any changes. While to date there has been no specific changes to the German foreign investment review regime due to the pandemic, according to a proposed amendment to the German Foreign Trade and Payments Act (AWG), the scope of the review will change from an "actual risk" to public order or public security to "probable impairment". Furthermore, the foreign investment review is to be become stricter for certain critical technologies, for example biotechnology.

Australia

The Australian Government has announced temporary changes (effective from 29 March 2020) to its foreign investment review framework so as to protect the national interest in light of the economic implications arising from the spread of COVID-19.

All proposed foreign investments into Australia subject to the Foreign Acquisitions and Takeovers Act 1975 (Cth) ("the Act") will require FIRB approval, regardless of the value of the investment or the nature of the foreign investor, where the other conditions for notification are met.

This reflects the monetary thresholds that apply to "foreign government investors", and private acquisitions in Australian media businesses, residential land proposals, mining and production tenements, and vacant commercial land proposals.

While the dollar sum "threshold test" will be met in relation to all acquisitions in Australian entities, businesses or land, the other conditions of a significant or notifiable action must also be met. There is no change to the meaning of "significant action" and "notifiable action" as presently provided.

As under the existing framework, acquisitions by private foreign investors of less than 20% in an Australian entity generally do not require approval (exceptions to this are Australian agribusinesses and land entities which require approval for acquisitions of more than 10%). This will continue to be the case.

To ensure sufficient time for screening applications, FIRB will extend the statutory timeframes for reviewing applications from 30 days to up to six months.

The new rules will not apply to agreements entered into prior to 10:30 pm AEDT 29 March 2020, including acquisitions that have not yet completed. FIRB has emphasised that the changes are temporary measures that will remain in place for the duration of the coronavirus crisis.

United States

Notably, the United States government has not announced additional restrictions on the acquisitions of US businesses in light of the COVID-19 crisis. The Committee on Foreign Investment in the United States (CFIUS) remains focused on national security, a concept encompassing critical infrastructure. Given the increasing awareness of vulnerabilities in the US medical supply chain, foreign investments in this sector could attract more scrutiny in the future. Further, CFIUS is continuing to process filings, notwithstanding the challenges of stay-at-home orders. At some point, there could be impacts on the ability of CFIUS to accept and process new filings.

A Global Trend?

In the last few years, some of the most influential economies have reformed their foreign investment review frameworks to allow the government more leeway to block deals or impose conditions on their completion. For example, the US, which has long maintained an open investment policy, recently enacted the Foreign Investment Risk Review Modernization Act (FIRRMA), designed to address evolving national security concerns. Canada, Australia and Germany have not been far behind in tightening foreign investment regulations, while, as stated above, the EU recently introduced a new framework for the screening of foreign direct investments that raise security or public order concerns for the EU or its Member States,. Meanwhile, the UK and Switzerland have indicated that they will for the first time introduce standalone foreign investment screening regimes in their jurisdictions.

This trend towards increased scrutiny of foreign investment has been primarily focused on addressing national security concerns. However, it now seems that some countries are using foreign investment screening to protect wider economic and social concerns triggered by COVID-19. At first, this approach seemed to be limited to Europe, which makes sense as this region has been declared, for now, as the "epicentre" of the global pandemic. However, as the virus continues to spread, other countries such as Australia, are beginning to take a similar stance to protect their own national interests and economies.

Again, while most cross-border transactions have a high likelihood of being approved, those in strategic sectors may encounter more scrutiny and face a prolonged approval process at this highly sensitive and volatile time. Taking the time to understand the rules and identify a regulatory strategy, including appropriate messaging and communication with the relevant governmental authorities, and the consequential impact on deal documentation, such as whether any closing condition is required, early in the deal process can minimize the risk of delays, last-minute changes to the deal structure, or even failed transactions.

Keeping up to date on changes in foreign investment review systems in this fast changing landscape will be crucial. Equally important is to understand the limitations that are currently being placed on the movement of products now considered essential in case the target company is affected. See our alert on this.

[1] Webcast, EU Industrial Policy in the Time of Coronavirus, Bruegel, Brussels, March 19, 2020; reported by MLex.

[2] Royal Decree-Law 8/2020, 17 March 2020.

[3] Decree 2019-1590 and a related order (arrêté) dated 31 December 2019.