

The rise of FDI regimes and their impact on M&A transactions

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UK follows global trend by introducing standalone national security investment screening regime

Foreign direct investment ("FDI") is an important part of the global economy: OECD data indicates that there was USD\$1,426 billion of global FDI in 2019. In recent years, governments around the world have shown an increasing desire to scrutinise and, if considered necessary, intervene in transactions involving FDI, motivated by a number of geo-political factors including rising protectionism, concern about cyber-security threats, and more recently the need to protect critical industries in response to the Covid-19 pandemic. There are exceptions – notably, China, Chile and the UAE have all relaxed their FDI rules to encourage foreign investment. However, the general trend is for governments to seek to exercise greater control over flows of FDI into their jurisdictions.

Against this backdrop, in November 2020 the UK took steps to enhance its ability to review and intervene in transactions which may give rise to national security concerns. The new UK National Security and Investment ("NSI") Bill (the "Bill"), when implemented into law, will introduce a mandatory notification and pre-approval requirement for transactions in key sectors of the UK economy which the UK government considers to be the most sensitive. This is backed up by a voluntary notification option for other sectors and a call-in power for transactions that have not been notified. The new regime will apply to a wide range of transactions (for example, there are no thresholds to exempt smaller deals; and asset, as well as share, deals are caught) – with powers to impose significant sanctions for non-compliance, including fines in the millions and potential imprisonment.

Key considerations for global M&A transactions

The increasing number and complexity of FDI regimes requires careful navigation when planning and executing global M&A transactions. Changes are happening quickly as governments seek to strike a balance between protecting critical industries without deterring foreign investment more generally. This will be felt acutely in the UK, where the government is simultaneously seeking to demonstrate the UK is 'open for business' post-Brexit while also toughening its powers to scrutinise investment.

For M&A planning purposes, some of the key considerations include:

- **More discretion for governments to intervene and less legal certainty as to the outcome:** Compared to other regulatory processes, such as merger control regimes for review of antitrust/competition issues, there is generally a greater degree of discretion under FDI regimes for governments to make substantive interventions. There is also generally less transparency, less publicly available precedent and less guidance. The result is a degree of uncertainty that needs to be factored into overall deal risk.
- **Timelines:** As with other regulatory approval requirements, where a transaction falls under one or more FDI regimes, there will be implications for the deal timetable. Reviews can take a number of months and, where transactions are subject to mandatory prior notification, this will prevent closing of the transaction even in circumstances where there are no substantive national security concerns. Early engagement on potential FDI notification obligations can help to mitigate the impact.
- **Conditionality:** Again, as with other regulatory approvals, split signing and closing arrangements and the inclusion of closing conditions may be necessary to deal with FDI requirements. Particularly where notification is voluntary, the extent and scope of the conditionality may be subject to some negotiation. The buyer may wish to make a voluntary notification to remove the risk of subsequent government intervention, whereas the seller will likely prefer to avoid delay and to minimise the risk of the buyer being able to walk away from the deal. The parties will therefore need to agree how the risks are shared, timing for satisfaction of conditions, and the extent of their respective obligations to achieve such satisfaction.
- **Key differences between regimes:** FDI regimes vary significantly by jurisdiction, adding complexity for cross-border transactions. A brief comparison of a number of key regimes is set out in the summary table below. Key differences to bear in mind include the following:
 - **Origin of investment:** The majority of FDI regimes, including those in **Australia, France, Germany, Spain** and the **US**, only apply to foreign investment. However, the regime in **Italy** and the **UK NSI** regime (as drafted in the Bill) are applicable to any investor, including domestic investors.
 - **Extraterritorial scope:** The **UK NSI** regime (as drafted in the Bill) has extra-territorial reach, in that it applies to investments in non-UK targets where they supply **UK** customers or carry on activities in the **UK**, so a purely foreign-to-foreign transaction could be caught. Similarly, the regimes in **Australia** and **Italy** extend to certain off-shore transactions. This is unlike many other regimes such as in **France, Germany** and the **US**.
 - **Scope of intervention:** The basis for government intervention varies. Some regimes have a narrower focus on "national security" or "public order" issues, such as in **Germany**, the **UK** and the **US**; whereas others have a broader scope, considering the "national interest", such as in **Australia, France** and **Italy**. (Note that, in addition to the new NSI regime, the **UK** government also has powers to intervene on "public interest" grounds in certain media and financial sector mergers.)
 - **Asset acquisitions:** Most jurisdictions, including **Australia, France, Germany, Italy**, the **UK** and the **US**, catch the acquisition of certain assets as

well as interests in corporate entities – so deal parties need to be aware that FDI regimes could apply no matter how a transaction is structured.

- **Voluntary vs. mandatory notification:** In some jurisdictions, such as **France, Italy** and **Spain**, where the relevant thresholds are met, there will always be a mandatory notification requirement. On the other hand, in the **US**, notification is predominately voluntary. Other jurisdictions, including **Germany**, the **UK** (as drafted in the Bill) and **Australia** have both mandatory and voluntary notification systems, depending on the sector and/or type of transaction.
- **Different control thresholds for review:** While most FDI regimes include certain thresholds for review based on the acquisition of control or a certain percentage of voting rights or shares in an entity, the relevant percentage and definition of control varies (including between different types of foreign investors in some jurisdictions). In contrast to merger control, only some jurisdictions (such as **Australia** and **Italy**) apply monetary thresholds with respect to their FDI regimes.
- **Response to Covid-19:** Many jurisdictions have introduced specific measures to secure the protection of key national assets and supply chains in light of the Covid-19 pandemic. Examples include: **Australia**, which had temporarily suspended the monetary thresholds which apply to its FDI regime; **France, Germany** and **Italy**, each of which have expanded the strategic sectors in which transactions require mandatory notification to include certain pandemic-related activities; and the **UK** which, prior to introducing the NSI Bill, introduced a similar ground for government intervention under the pre-existing merger control laws. By contrast, the **US** has not introduced any new formal powers as a result of Covid.

The table below provides a high level overview of the key features of a number of significant FDI regimes.

	UNITED STATES	UNITED KINGDOM ¹	FRANCE	SPAIN	GERMANY	ITALY	AUSTRALIA
Substantive test for intervention	National security	National security	National interest	Public security, public order or public health	National security or public order	National interest	National interest or national security
Foreign investors only?	✓	✗	✓	✓	✓	✗	✓
Mandatory/voluntary notification?	Generally voluntary, but mandatory filings for certain foreign government-backed investments and certain foreign investments in critical technologies	Mandatory and voluntary notification, depending on the transaction/sector	Mandatory, for certain acquisitions in certain regulated sectors	Mandatory, for certain acquisitions in certain strategic sectors	Mandatory and voluntary notification, depending on the transaction/sector	Mandatory, for certain acquisitions in certain regulated sectors	Mandatory and voluntary notification, depending on the transaction/sector
Applies to asset-only deals?	✓	✓	✓	✓	✓	✓	✓
Extra-territorial effect?	✗	✓	✗	✗	✗	✓	✓
Nature of investment subject to review	Transactions of any size may be reviewable, depending on the investor rights conveyed	Depending on the acquirer and target, thresholds for mandatory notification start as low as 15% of voting rights	Depending on the acquirer and target, thresholds for notification start as low as 10% of voting rights	Depending on the acquirer and target, thresholds for notification start as low as 10% of share capital	Depending on the acquirer and target, thresholds for mandatory notification start as low as 10% of voting rights	Depending on the acquirer, target and transaction value, thresholds for notification start as low as 10%	Depending on the acquirer, target and transaction value, thresholds for mandatory notification start as low as 5% of voting rights

¹ Note: regime expected to come into force during 2021 and to apply retrospectively to deals closed from 12 November 2020 onwards.

	UNITED STATES	UNITED KINGDOM ¹	FRANCE	SPAIN	GERMANY	ITALY	AUSTRALIA
		Voluntary notification may be relevant where "material influence" is acquired			Voluntary notification may be relevant where 25% or more of voting interests are acquired	of share capital in regulated sectors (or 3% where the target is directly involved in defence and national security)	Voluntary notification may be relevant for other "significant actions"
Timing for review (approx.)	2-6 months	3-4 months	2-3 months	Up to 6 months	2-6 months	1-4 months	1-3 months
Prohibition on transaction closing until cleared?	X (If mandatory notification, must file 30 days prior to closing)	✓ (For mandatory notification)	✓	✓	✓ (For mandatory notification)	✓	✓
Decision-maker	Committee on Foreign Investment (CFIUS), President of the United States	Secretary of State for Business, Energy & Industrial Strategy	Minister of Economy through the Foreign Investment Office	Council of Ministers 20 January 2021	Federal Ministry for Economic Affairs and Energy	Department for Administrative Coordination	Australian Treasurer
Potential Penalties	Fines up to the transaction value	Fines up to the higher of £10m or 5% of annual revenue; potential imprisonment	Fines up to the higher of twice the transaction value, 10% of annual revenue or €5m; potential imprisonment	Fines up to the transaction value	Fines up to €10m, potential imprisonment (for breach of standstill obligation)	Generally fines of at least 1% of annual revenue, up to twice the transaction value	Fines up to A\$555m; potential imprisonment

Working at the intersection of business and government, Hogan Lovells' Global Regulatory team is uniquely placed to advise clients on transactions which may fall under one or more FDI regimes around the world.

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