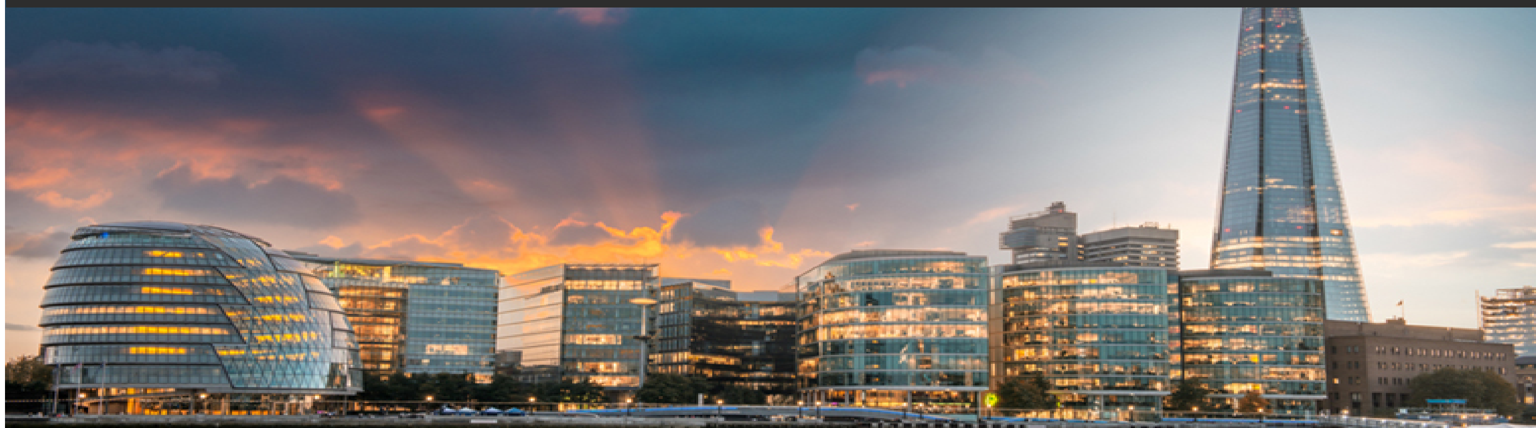
GT GreenbergTraurig | 50TH ANNIVERSARY

Alert | Antitrust Litigation & Competition Regulation



October 2017

Foreign Investment and National Security: Stricter Controls Proposed by the EU and UK

Within the last few weeks, both the EU and the UK have published proposals for greater screening and control of foreign direct investments (FDI) into their territories. In both cases, these proposals seek to balance the protection of critical national infrastructure and technology on the one hand and an open foreign investment environment on the other.

EU Proposals

The EU proposals seek to address an increase in inward investments by individuals and businesses from emerging economies such as Brazil and China, whose share of investment into the EU over the past 20 years has increased by over 1000 percent and 600 percent respectively.

Existing Controls

There is no EU-wide regime for the screening of FDI. Under the current EU merger regime, the European Commission can investigate FDI in the form of mergers, acquisitions, and joint ventures that exceed sizeable financial thresholds. In these cases, however, the Commission's investigation is on competition grounds only, and the EU Merger Regulation expressly reserves to the national authorities of the 28 EU Member States the power to block or impose conditions on the transaction to protect legitimate public interests, which are currently recognised as being public security, media plurality and prudential rules. The Member States are not required to report their decisions to the Commission, but if they wish to extend the category of legitimate interests, they must seek the Commission's approval.

© 2017 Greenberg Traurig, LLP

Twelve Member States, including the UK, have systems for protecting national interests, and each system differs from the others.

Draft Regulation

The Commission's proposals, in the form of a draft regulation published on 13 September 2017,are not intended to centralise FDI controls in Brussels, nor to require every Member State to screen FDIs. Instead, the proposals are intended to preserve the Member States' existing powers, to the extent they wish to use them, whilst harmonising the approaches they use in applying their rules on screening two particular national interests – security and public order.

The proposals also give the Commission the power to screen on the grounds of security and public order any FDIs that affect projects and programmes of EU interest. In addition, they establish mechanisms for communication and cooperation among the Member States and the Commission in this area.

The draft regulation defines "screening" as "a procedure allowing to assess, investigate, authorise, condition, prohibit or unwind foreign direct investments". The term "foreign direct investment" means an investment of any kind by a foreign investor (defined as a natural person or undertaking of a third country), where the aim of the investment is to establish or maintain lasting and direct links between the foreign investor and the entrepreneur or undertaking receiving the capital in order to carry on an economic activity in a Member State. The term includes an investment that enables effective participation in the management or control of a company carrying out an economic activity, so it covers a broader range of transactions than mergers, acquisitions, or joint ventures.

Although the terms "security" and "public order" are not defined, screening can include consideration of the impact of the FDI on:

- critical infrastructure (including energy, transport, communications, data storage, space or financial infrastructure, and sensitive facilities),
- critical technologies (including artificial intelligence, robotics semiconductors, technologies with potential dual use applications, cybersecurity, space, or nuclear technology),
- the security of supply of critical inputs, or
- access to, or the ability to control, sensitive information.

Screening can also take into account whether the foreign investor is controlled by the government of a third country, including through significant funding.

Where a Member State engages in FDI screening, the draft regulation sets out certain procedural requirements:

- The screening mechanisms used must be transparent – the Member State must set out the circumstances triggering the screening, the grounds for the screening, and the detailed rules that apply.
- The screening mechanisms must not discriminate between third countries.
- The Member State must notify the Commission and Member States within 5 days of the start of screening any FDI.

© 2017 Greenberg Traurig, LLP

- There must be a timeframe for issuing the screening decision which makes allowance for responding to information requests from the other Member States and the Commission and the subsequent 25-day (extendible) deadline for comments from other Member States and for the Commission to issue an advisory opinion.
- Confidential and commercially sensitive information belonging to the foreign investor and the relevant businesses must be protected.
- There must be an opportunity for judicial redress against the Member State's screening decision.

The Commission may issue an advisory opinion whether or not a Member State has a screening mechanism and whether or not a Member State that has a screening mechanism chooses to use it in any particular case.

In addition, Member States must notify the Commission of their existing screening mechanisms within 30 days of the regulation entering into force and must keep the Commission informed of any changes or replacements. They are required to provide the Commission with an annual report on the application of their screening mechanisms, and Member States that do not have screening mechanisms must nevertheless report annually on any FDIs that have taken place in their territory.

If approved by the European Parliament and Council, the regulation is likely to come into force in early 2019.

Additional Measures

In parallel with introducing the regulation, the Commission will also carry out during 2018 a detailed analysis of FDI flows into the EU and will set up a co-ordination group involving representatives of the EU Member States, to enable it to identify joint strategic concerns and solutions relating to inward FDI.

UK Proposals

On 17 October 2017 the UK Government published a Green Paper setting out a two-part proposal aimed at tightening existing controls over investments, particularly but not exclusively foreign investments, that may have national security implications. These proposals are designed to address new national security challenges brought by emerging technologies and questions raised by recent transactions regarding the sufficiency of the UK merger regime to protect the UK's national security effectively. The Green Paper specifically references the FDI in Hinckley Point C nuclear power station in 2016.

Existing Controls

Currently, the UK Government can rely on public interest grounds to intervene in the acquisition of control or material influence over a business in two alternative scenarios. The first is where the thresholds in the UK merger regime are met: either the target has UK turnover exceeding £70 million or the transaction results in an increase of 25 percent or more in the merging businesses' combined share of supply of products or services in the UK. The second is where these thresholds are not met but the transaction is a "special merger situation" involving a defence contractor or a media company. There are currently three public interest grounds – national (including public) security, media plurality, and financial security.

© 2017 Greenberg Traurig, LLP

However, there is no specific provision in this system for intervention for small transactions involving suppliers of security-related equipment, software, or technology that are not defence contractors, nor in technologically significant investments, nor in investments in new projects involving critical national infrastructure, such as new-build nuclear power stations. In addition, notification is voluntary and a transaction may be completed without UK merger clearance – although the UK Competition and Markets Authority (CMA) may intervene on its own initiative and use its power to block or unwind a problematic transaction.

The government has further powers to protect national security in sectoral legislation governing the water, communications, energy, civil nuclear, and manufacturing industries. It also has broader powers under the Civil Contingency Act 2004 to impose emergency regulations to address actual or threatened emergencies. However, these do not comprehensively address new concerns regarding advanced technology and critical infrastructure.

Short-term Proposals

Recognising that national security concerns can arise in relation to small as well as large companies, the Government's short-term proposal seeks to lower the turnover threshold in the UK merger regime from £70 million to £1 million and remove the share of supply requirement so that it can investigate mergers involving:

1. businesses active in the manufacture or design of military items (such as arms and military and paramilitary equipment) and dual use items (items that can have both military and civilian uses) included in UK strategic export control lists; and

2. parts of the advanced technology sector relating to the design of multi-purpose computing hardware, computer chips, and quantum technology.

As a result of the threshold amendments, these types of transactions would also be subject to a competition review as well as a review of national security concerns. These changes will be enacted as a matter of priority by way of secondary legislation, the wording of which is currently open for consultation for four weeks until 14 November 2017.

Long-term Proposals

The Government's longer-term proposal, open for consultation for 12 weeks until 9 January 2018, sets out two options for reform which may be adopted separately or in combination.

1. ***Voluntary notification: An expanded version of the merger control "call in" power for national security reasons***

Expanded call-in powers would allow the Government to scrutinise a broader range of transactions, including transactions outside the scope of the merger regime, such as new projects and sales of bare assets (*e.g.*, plots of land, machinery or intellectual property), which give the acquirer significant influence or control over a company or its assets or businesses in the UK and which the Government reasonably believes may raise national security concerns.

Under this proposal, notification to the Government would be made on a voluntary basis, the intention being that the majority of mergers that do not raise concerns should not be held up unnecessarily – although the Green Paper recognises that this has the potential to create uncertainty. The Government

© 2017 Greenberg Traurig, LLP

would have set time within which to intervene – for example, three months from completion of the transaction.

2. ***Mandatory notification: Foreign investment in the provision of a focused set of "essential functions" in key parts of the economy***

Under this model, mandatory notification could be required:

a. for foreign investment in companies which undertake, or are crucial to the undertaking of, essential functions which the Government views as critical to ensuring the national security of the UK;

b. where foreign ownership or control could pose a risk which there are no other reasonable means of adequately mitigating; and

c. where existing licensing or regulatory regimes are insufficient to provide the Government with the information and powers required to protect national security.

Sectors to which the regime would apply would likely include the civil nuclear, defence, energy, telecommunications, transport, military, and advanced technology sectors. This is not a closed list, however, and the Government is considering inclusion of the government and emergency services sectors, as well as businesses which supply critical services or goods to national infrastructure firms as potentially within the scope of the proposed regime.

Enforcement

The Government's powers under these new provisions would reflect its existing merger control power, which extend to approving a transaction unconditionally, imposing conditions on approval and requiring a transaction to be abandoned or, in the case of a completed transaction, unwound. Its decisions would be subject to juridical redress. Non-compliance with mandatory notification requirements could carry a risk for individuals, in the form of criminal prosecution, financial penalties and director disqualification.

Comment

The EU and UK proposals reflect a global trend towards increasing control of foreign investment, particularly from non-EU countries which limit access to EU investors. At the same time, they reflect a recognition that foreign investment makes a significant contribution to the economy and should be encouraged.

Whether the right balance has been struck in each case remains to be seen. The EU proposals have already met with criticism from some Member States that favour a more liberal approach, and the Council of the EU has appointed a panel of trade defence experts to assess the proposals, both of which may prolong the debate. In the meantime, it is unclear how the proposed UK regime, which would include mandatory notification for the first time in its history, will interact with the proposed EU foreign investment screening framework either before or after Brexit.

© 2017 Greenberg Traurig, LLP

Authors

This GT Alert was prepared by **Gillian Sproul** and **Addiped Cheng**‡. Questions about this information can be directed to:

- Gillian Sproul | + 44 (0) 203.349.8861 | sproulg@gtlaw.com
- Addiped Cheng‡ | +44 (0) 203.349.8700 | chenga@gtlaw.com
- Or your Greenberg Traurig attorney

‡ *Qualified in Hong Kong.*

Albany. Amsterdam. Atlanta. Austin. Boca Raton. Boston. Chicago. Dallas. Delaware. Denver. Fort Lauderdale. Germany.¬ Houston. Las Vegas. London.* Los Angeles. Mexico City.+ Miami. New Jersey. New York. Northern Virginia. Orange County. Orlando. Philadelphia. Phoenix. Sacramento. San Francisco. Seoul.∞ Shanghai. Silicon Valley. Tallahassee. Tampa. Tel Aviv.^ Tokyo.¤ Warsaw.~ Washington, D.C.. West Palm Beach. Westchester County.

*This Greenberg Traurig Alert is issued for informational purposes only and is not intended to be construed or used as general legal advice nor as a solicitation of any type. Please contact the author(s) or your Greenberg Traurig contact if you have questions regarding the currency of this information. The hiring of a lawyer is an important decision. Before you decide, ask for written information about the lawyer's legal qualifications and experience. Greenberg Traurig is a service mark and trade name of Greenberg Traurig, LLP and Greenberg Traurig, P.A. ¬Greenberg Traurig's Berlin office is operated by Greenberg Traurig Germany, an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. *Operates as a separate UK registered legal entity. +Greenberg Traurig's Mexico City office is operated by Greenberg Traurig, S.C., an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. ∞Operates as Greenberg Traurig LLP Foreign Legal Consultant Office. ^Greenberg Traurig's Tel Aviv office is a branch of Greenberg Traurig, P.A., Florida, USA. ¤Greenberg Traurig Tokyo Law Offices are operated by GT Tokyo Horitsu Jimusho, an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. ~Greenberg Traurig's Warsaw office is operated by Greenberg Traurig Grzesiak sp.k., an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. Certain partners in Greenberg Traurig Grzesiak sp.k. are also shareholders in Greenberg Traurig, P.A. Images in this advertisement do not depict Greenberg Traurig attorneys, clients, staff or facilities. No aspect of this advertisement has been approved by the Supreme Court of New Jersey. ©2017 Greenberg Traurig, LLP. All rights reserved.*