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Professional Perspective

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A takeover of a French company carrying on so-called 'sensitive' activity in France by a company ultimately controlled by foreigners—European Union and non-EU—is subject to the prior authorization of the Ministry of the Economy, Industry and Digital Sector. The recent increase in foreign direct investment authorization requests and the announced veto position of the French state on the Photonis/Teledyne prompts us to review the main aspects of this authorization procedure and its consequences for M&A transactions. As national security foreign investment review regimes increase in number and importance globally, this article looks at the French review mechanism, or U.S. CFIUS counterpart.

The authorization procedure is far from being a French specificity and there are similar procedures—often even more restrictive—in England (Enterprise Act), Germany (Foreign Trade Act), Canada (Sept. 17, 2009 regulation), and the U.S. (CFIUS), for example. In 2019, the EU committed itself to the effective implementation, by fall 2020 at the latest, of a tool that would filter and coordinate the monitoring of foreign investment in EU member states based on the exchange of information and cooperation.

But foreign investors should not be alarmed. Even if the control of national interests is henceforth intended to be stricter, as long as the stakes are well anticipated upstream and the procedure has been properly and rigorously prepared prior to the submission of the application for authorization, the completion of the contemplated transaction should not be hindered.

Regulatory Regime

Although the French Monetary and Financial Code (FMFC) states that financial relations between France and foreign countries are free, the defense of national interests tempers this principle by subjecting, in particular, foreign investments in France to a mandatory prior authorization procedure. Articles L. 151-3 and R.151-1.

The regime has changed significantly over the past five years. In line with the Montebourg Decree and the PACTE Act (Action Plan for Business Growth and Transformation), the Dec. 31, 2019 Decree 2019-1590 and Ministerial Order on Foreign Investment, which apply to operations notified to the French state as of April 1, 2020, reflect both the need to simplify and enhance efficiency and, more globally, to protect the national interests whose definition is becoming increasingly broad.

Furthermore, the extension of the use of the golden share under the PACTE Act, Article 154, by the French government will allow broader protection of strategic companies. The health crisis and its economic and strategic consequences on the notion of national interest will probably lead to an extension of the scope of "sensitive" activities.

To determine whether the transaction you are considering is subject to prior authorization, it is necessary to examine the legal structure of the transaction itself and determine whether the target carries on one or more of the activities listed in Article R.151-3 of the FMFC. A positive answer to these two questions will trigger the obligation to file a request for prior authorization. Finally, this procedure will be very likely to have an impact on the structure, the timing and the legal documentation governing the contemplated M&A transaction.

Review for Prior Authorization

Does the contemplated transaction qualify as a foreign investment in France?

Pursuant to the FMFC Article R. 151-2, the acquisition of a company or a branch of activity of a company whose registered office is established in France constitutes a foreign investment. The notion of control is widely understood and includes both de jure and de facto control, assessed both directly and indirectly. Finally, if the investor is a foreigner from outside the EU, or outside the EEA countries with an agreement covering administrative assistance against tax evasion and fraud, the crossing of a 25% threshold, or even 10% under the health crisis temporary regime, declared April 29, 2020, of the voting rights of a French company will constitute a foreign investment in France.

The investor will have to consider the degree of sensitivity of the activity. Thus, an indirect minority stake in a French company with military activity could be considered an indirect takeover, jointly with the other shareholders, in the name of the legitimate protection of national interests.

Does the target carry on a sensitive activity?

The activity is deemed sensitive when the target has activity in France which, even on an occasional and/or residual basis, contributes to the exercise of public authority, is of a nature that may undermine public policy, public security, or national defense interests or constitutes an activity of research, production or marketing of arms, munitions, powders, and explosive substances. Article L. 151-3. For instance, as a general rule, the nuclear sector, aeronautics, and all activities with military applications fall within the definition of "sensitive" activities.

The developments in technology and of the criticality of certain sectors in a global context have resulted in the entry of new activities into the list of protected sectors in the code. In addition to the traditional sectors, those related to energy security, food security, information security, and the protection of critical technologies (e.g., artificial intelligence, cyber security, energy storage, quantum technologies, all in Article 6) have gradually been added. Further to this, as a result of the Covid-19 pandemic, biotechnology companies will also be classed in the 'sensitive activities' field.

In case of doubt as to the sensitive nature of an activity or branch of activity, the target company may seek the opinion of the Ministry of the Economy and Finance, alone or in consultation with the foreign investor. This opinion should be issued within two months. Article R. 151-4. In the event of a positive opinion, the investor will have to submit a formal request for authorization if it intends to proceed with an acquisition.

Prior Authorization Procedure

Application for Authorization

If the contemplated transaction is subject to authorization, the investor must submit an application for authorization to the Foreign Investment Bureau. The file must contain information identifying the investor and their ultimate beneficiaries, financial resources, strategy, and possible links with foreign governments or state-owned enterprises. The Foreign Investment Bureau will then question the various administrations concerned and gather initial reactions and requests for additional information, such as details on the structure of the investment, the investor's activities, etc. The decree and the Dec. 31, 2019 order clarified the phase of examination of the request for authorization with the creation of two instruction phases.

Phase 1 Examination

The Ministry of the Economy and Finance must inform the investor, within 30 working days of receipt of the application, as to whether the contemplated transaction can be carried out without conditions or requires further examination in view of the issues it raises. Article R. 151-6. In the absence of a response from the Ministry of the Economy and Finance within this period, the application for authorization is deemed to be rejected. The text does not specify whether the deadline runs only if the application is "complete."

Phase 2 Examination

If the Phase 1 examination reveals that the intended transaction raises issues of national interest, the Ministry for the Economy and Finance will notify the investor that the transaction requires further examination. The additional examination will last 45 working days from the date of receipt of the ministerial decision to open this second phase of examination.

As part of the further review, the Foreign Investment Bureau will hold discussions on the terms of the commitments (the "conditions") that may be requested from the investor in order to obtain the ministerial authorization.

At the end of this additional examination phase, the Minister of the Economy may formulate three types of responses:

- The authorization is granted with no conditions (quite rare at this stage).
- The authorization is given subject to conditions. Article R. 151-6 al.2 and R. 151-8.
- The request is refused with justification. Article R. 151-10.

The latter case has, in practice, been quite rare because a well-prepared file is likely to identify the likelihood of a refusal early in the process. The text specifies that, here again, the absence of a response is equivalent to a refusal.

Penalties for Non-Compliance

The completion of a transaction without having sought or obtained the authorization of the Minister of the Economy and Finance exposes any Investor to heavy penalties.

First, the transaction would be null. Article L. 151-4. Furthermore, the Ministry of the Economy and Finance has a range of measures that can be ordered to ensure compliance with the regulations included in Article L. 151-3-1. These are:

- Injunction to file an application for authorization, to restore the situation prior to the completion, to modify the investment. These injunctions may be combined with a penalty payment of up to €50,000 per day.
- Suspension of the voting and financial rights attached to the target's shares.
- Suspension, restriction or prohibition of the use of certain assets of the target.
- Designation of an administrator to ensure the protection of national interests. Thus, this administrator will be empowered to block any decision of the corporate bodies.

Persistent refusal to comply may also result in a fine of the greater one of the following, according to Article L. 151-3-2:

- Twice the amount of the investment
- 10% of the target's annual turnover before tax
- Five million euros for legal entities and one million euros for individuals

In practice, such non-compliance would certainly make the possibility for the investor to make an investment in a sensitive business in France in the future very uncertain.

Life of the Authorization

Once an authorization with conditions has been granted, the investor must ensure permanent compliance with these conditions; indeed, the Ministry of the Economy and Finance may require such compliance from the investor and can use its power to impose penalties. Persistent or serious non-compliance may lead to the withdrawal of the authorization and the obligation to restore the situation prior to the acquisition or to request a new authorization.

The conditions of the authorization may be modified in the event of a change in the elements contained in the authorization application with respect to the investor, or the economic situation of the target or in application of one of the conditions. Article R. 151-9. An application for revision must then be flagged to the French state or, as the case may be, to the investor.

If the investor is the author of the request for review, the Ministry of the Economy and Finance must decide within 45 working days as from the receipt of the request for review. If the Ministry intends to review the conditions, the Investor will be invited to submit comments within 45 working days as from the receipt of the review proposal. At the end of this period, the Ministry will notify the investor of the updated conditions.

Impact on M&A Transactions

This reminder of the main stages in the issuance procedure and the life of an authorization highlights the following impacts on M&A transactions.

Adequate Upstream Preparation by Seller and Investor

Thus, if the seller anticipates the sale of the target operating a sensitive activity to a foreign group, it is recommended that it carry out various upstream actions to facilitate the completion of the transaction. For instance, if the “sensitive” activity is not very significant and autonomous, a prior sale to a French third party could possibly simplify the main operation or simply make it possible.

The investor will have to determine as soon as possible whether the target is defined as a “sensitive” activity. The assessment is straightforward when it concerns the target's main activity. However, the analysis is more delicate when the activity is secondary or residual. Advisers should raise this issue in a practical and operational manner as early as the letter

of intent discussions and pay particular attention to it during due diligence. The investor will also have to ensure that its acquisition structure is clear and acceptable to the relevant departments of the French state.

Timing of Request for Authorization

If the texts provide for a maximum period of 75 working days, the assessment of the "completeness" of the application file should be taken into account. In practice, prior to the reform, it was common to obtain authorization, key to its success, within 3 to 4 months. The new time limits set by Article R. 151-6 of the French Monetary and Financial Code have been aligned with the time limits observed in practice to make them clearer for Investors. Of course, the justification of serious time constraints or upstream preparation of the application could and will always make it possible to get the authorization within a shorter timeframe. These timeframes may be particularly significant for the management of conditions precedent and the interim period and/or if the target is experiencing financial difficulties, and/or is under pre-bankruptcy procedures.

Impact on Legal Documentation

Finally, the request for authorization will inevitably have consequences on the legal documentation and in particular the acquisition agreement, which must include the grant of the Ministerial Authorization as a condition precedent. Furthermore, the investor must exercise caution and carefully assess the scope of the conditions that may be requested by the French state (protection of sensitive information, creation of restricted areas, etc.) and the management of the target during the interim period between the signing of the agreement and the actual completion.