

UK's Proposed Investment Scrutiny Powers Are Far-Reaching

By **Douglas Lahnborg** and **Matthew Rose** (September 10, 2018, 3:35 PM EDT)

The recently issued National Security and Investment White Paper proposes a significant expansion in the U.K. government's powers to scrutinize foreign investment beyond those available in other leading economies.

The white paper introduces powers to intervene in a broad range of transactions in any sector, regardless of deal value, the transaction parties' market shares or revenue. If the proposals are brought into force in their current form, the U.K. regime would be one of the most stringent in the world, with wide-ranging implications for foreign and domestic companies and projects in sensitive sectors, including technology, energy, infrastructure, telecommunications, real estate and financial services.

Existing Powers

The government monitors investment risks to national security through the merger control regime, certain sector regulation and export control. Under the merger control regime, the government's ability to intervene is limited to specific issues of "public interest" if there is a "relevant merger situation" under the Enterprise Act 2002.

Key Elements of the White Paper

The white paper sets out far-reaching and significantly expanded powers to scrutinize proposed investments based on national security concerns.

Trigger Events

The white paper proposes voluntary notification for the following "trigger events" that may raise national security concerns:

- More than 25 percent of shares or votes are acquired in an entity;
- Significant influence or control over an entity is acquired;



Douglas Lahnborg



Matthew Rose

- Further significant influence or control over an entity is acquired;
- More than 50 percent of an asset is acquired (including real assets, land and intellectual property); or
- Significant influence or control over an asset is acquired.

In a statement of policy intent, the government identifies three situations where these trigger events might give rise to national security concerns:

- “Target risk” — whether the entity or asset could be used to undermine national security;
- “Trigger event risk” — whether the trigger event may give the acquirer the means to undermine national security; and/or
- “Acquirer risk” — whether details about the acquirer itself poses a risk if it were to use its acquisition of control over the entity or asset.

Procedure and Sanctions

When a trigger event is in contemplation, in progress or has taken place and at least one risk factor is present, either or both of the transaction parties may make a voluntary notification to the government. The government then has up to 30 working days to “call in” the transaction for further review. If a trigger event has taken place but has not been notified, the government has up to six months to call in the transaction.

To call in a transaction, there must be: (1) reasonable grounds for suspecting that a trigger event is in contemplation, in progress or has taken place; and (2) a reasonable suspicion that there is a risk to national security. Before exercising these powers, the government must consider whether there is another, less intrusive, way to protect national security. A decision to call in a transaction will be made public.

After a period of up to 75 working days, the government will inform the parties of the outcome of its review. It may also request further information and “stop the clock” pending responses to those requests, potentially extending the timeline further. The transaction must not be completed during the review period.

If any restriction or condition is breached, or a transaction is completed without prior authorization, sanctions may be imposed. Criminal sanctions include unlimited fines and/or up to five years’ imprisonment. Civil sanctions include, for a business, a fine of up to 10 percent of worldwide turnover, and for an individual, a fine of up to 10 percent of total income or 500,000 pounds (whichever is higher). For a business or individual who fails to provide information when requested to do so, sanctions include a one off fine of up to 30,000 pounds or a daily fine of up to 15,000 pounds. In addition, a director may be disqualified from serving as a director for up to 15 years.

Outcomes and Appeals

A transaction can proceed if the government decides that it does not raise concerns. If, however, the government considers that the transaction poses a security risk, it may prohibit the transaction or allow

it to complete with restrictions and conditions.

Where the government calls in a transaction post-completion and considers it poses a risk to national security, it may make an “Unwind Order” reversing the transaction. Appeals can only be made against the lawfulness of this decision, not the merits. Appeals will be heard by the High Court and must be brought within 28 days.

Implications of the New Powers

The new rules may add substantial uncertainty to deal timetables. The government has up to six months from a trigger event to call in a transaction. Even for transactions that are voluntarily notified, this process could take up to 105 working days (or longer if the clock is stopped).

Additional work may be required to determine whether a trigger event might occur, including enhanced due diligence on the identity of the acquirer or its ultimate owner(s).

This process is separate from any parallel merger control proceedings, further increasing the administrative burdens and costs for parties. The white paper notes that national security considerations would be removed from U.K. merger control. The government considers that the protection of national security trumps competition considerations and may, therefore, overrule a decision made by the Competition and Markets Authority if it considers it necessary to protect national security.

These powers extend beyond measures currently in place or being contemplated in other leading economies. The list of trigger events, for example, is not sector specific. The government has the ability to review a broad spectrum of transactions in any sector, regardless of deal value, including acquisitions, whether whole or partial, of shares, businesses and/or assets.

Restrictions on Foreign Investment in Other Jurisdictions

European Union

Under the EU Merger Regulation, the European Commission has exclusive jurisdiction to review mergers which meet certain turnover-based thresholds. EU member states, however, are permitted to take appropriate measures and apply their own laws to protect their legitimate interests in instances limited to public security, media plurality and prudential rules. The U.K. government may, for example, apply domestic legislation to mergers which would otherwise be under the exclusive jurisdiction of the European Commission in order to protect national security interests.

Currently, an EU-wide foreign direct investment screening regulation is at the early stages of European Parliament approval. The draft regulation aims to establish a framework for scrutinizing foreign investment in the EU and creates a cooperation and communication mechanism among member states and the European Commission.

The U.K.’s exit from the EU may affect implementation of the screening regulation in the U.K. The white paper contemplates that if the proposed regulation comes into force before the end of the “Implementation Period” in December 2020, the U.K. will become subject to it until the implementation period concludes.

France

In June 2018, the French government presented legislation to reform its foreign investment rules. “Le plan d’action pour la croissance et la transformation des entreprises” looks to extend the scope of the French “Prior Authorisation Regime” (in which material transactions in certain sensitive sectors are subject to prior governmental authorization) to certain key technologies and make it more efficient by expanding the applicable remedies and sanctions. The draft legislation is expected to be debated before the French parliament in late 2018.

The proposal sets out four main reforms, including extending the list of affected sectors to include semiconductors, space technology and drones, artificial intelligence, cybersecurity, robotics and “big data” storage, expanding the remedial powers to include injunctive relief to enforce the regime, reinforcing financial sanctions and modifying the notification procedure in respect of French target companies.

Germany

There are currently two distinct procedures that allow the German government to investigate any acquisition of 25 percent or more of the voting rights of a German company. Note that the government is currently considering the possibility of decreasing this threshold from 25 percent to 15 percent.

The first, “cross-sector” procedure applies to acquisitions by investors from outside the EU and the European Free Trade Association. It is not limited to any particular industry or sector of the economy; however, for companies that fall under the “critical industries” list, there is an obligation to report a proposed acquisition. The second, “sector specific” procedure is limited to acquisitions in certain defense and IT security companies. It applies to all acquisitions by non-German investors, including investors from other EU or EFTA member states, and it always requires a notification to the government.

Under the cross-sector procedure, the government has up to four months to review a transaction after receipt of all required information. In the absence of a notification, an investigation may be commenced up to five years after the completion date of the transaction. The sector specific procedure comprises two phases of three months each. It should be noted that the review periods of both procedures may be extended, in particular where the parties negotiate commitments with the government.

To date, there has been no prohibition decision under either procedure. However, transactions have been aborted when faced with the possibility of a prohibition decision. Most recently, the Chinese industrial company, Yantai Taihai, abandoned its plan to take over Leifeld Metal Spinning, a German company with robotics and nuclear expertise. The government considered that the transaction could endanger Germany’s national security as Leifeld’s machine tools are used to manufacture components for the aviation and aerospace industry, which could have implications for the defense sector.

United States

The Committee on Foreign Investment in the United States is tasked with monitoring investments into the U.S. to ensure that they do not threaten its national security. CFIUS has authority to examine transactions that could result in a non-U.S. person gaining control over a U.S. business. The U.S. president is authorized to block such a transaction — or to order divestment where such a transaction has been completed — if he or she determines that the transaction threatens U.S. security.

The Foreign Investment Risk Review Modernization Act and related soon-to-be-enacted export control legislation emerged from concerns in the Congress about the potential acquisition of U.S. technology by China. The new statutes will provide for far-reaching arrangements to identify and control “critical technologies.” They will include new categories of “emerging and foundational technologies” that U.S. officials conclude are important to U.S. technology leadership.

China

Since its adoption of the “open-door” policy, China’s economy has benefited from foreign investment. However, China has since imposed various restrictions on foreign investment. There are, for example, certain caps on the amount of shares a non-Chinese entity can hold in a Chinese company and some sectors have outright prohibitions on foreign ownership.

Recent changes have, however, been made to encourage more foreign companies to invest in China. In June 2017, Chinese government agencies released Foreign Investment Industrial Guidance Catalogue, which was updated in June 2018, or the negative list. The updated negative list reduces the industries restricted for foreign investment from 63 to 48, lifts foreign investment restrictions on various sectors, including agriculture, aircraft, automobile and banking, while maintaining restrictions or prohibitions on certain sensitive industries, such as telecommunication and internet value-added services, legal services, newspaper, education, media, TV and film.

Recently, a few Chinese government agencies jointly published a draft “Administrative Measures for Foreign investors’ strategic investment into Listed Companies” for public comments. According to this draft, foreign investors are permitted to acquire shares in a Chinese listed company by means of a share swap without prior approval, as long as the Chinese company’s business does not fall within the negative list. If adopted, this will provide a new means for foreign investment into China.

Despite that, recent geopolitical tensions between the U.S. and China have been attributed to Chinese regulators’ refusal to grant its antitrust approval for a deal between U.S. chip manufacturer, Qualcomm and its Dutch rival, NXP.

Douglas Lahnborg is a partner and Matthew Rose is a senior associate at Orrick Herrington & Sutcliffe LLP.

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