RECENT FOREIGN INVESTMENT REFORM: WHAT IMPACT WILL IT HAVE ON YOUR M&A TRANSACTIONS?

Interview with Emily Xueref-Poviac, Counsel, Clifford Chance LLP

CLIFFORD

CHANCE

Special issue compiled and edited by Marina Guérassimova and Professors David Chekroun, Gilles Pillet (ESCP Business School)
Interview conducted with the assistance of Marie Ghérardi Lévêque and Paul Agard, students of the Specialised Master in International Business Law and Management at ESCP Business School

Will foreign investment control become, alongside competition law and compliance, the third pillar of M&A?

Emily Xueref-Poviac: Foreign investment control has become a key issue that investors need to consider when carrying out transactions in sectors falling within the scope of this new framework.

In the same way as for merger control, the risk of a foreign investment control review must be taken into account when considering both deal certainty and the timing of completion.

As such, a multi-jurisdictional analysis must be carried out to identify the jurisdictions in which foreign investment control is likely to apply, and competent authorities should be contacted as soon as possible to anticipate any potential commitments required of the parties.

With regard to the impact of foreign investment control on operations carried out in France, it is worth noting that France has one of the most elaborate control mechanisms, which is also the oldest in Europe. As early as 1966, France established a control regime and a pre-authorisation requirement (overseen by the Ministry of the Economy) for certain foreign direct investments, particularly in the defense sector.

Following the takeover of Alstom's energy division by the American group, General Electric, the so-called 2014 "Montebourg" decree expanded the scope of control of foreign investments to six new sectors. The aim was to target new activities beyond security and defense, such as water and energy supply, transport and electronic communications networks and services, and the health sector.

Since 2014, the legal arsenal for controlling foreign investment has expanded considerably, particularly following the latest major reform in 2019.

Thus, Decree No. 2019-1590 of 31 December 2019 (the "Decree") and the Order of 31 December 2019, supplementing the Loi Pacte, have strengthened, as of 1 April 2020, the foreign investment control regime insofar as an investment is made in a (listed or unlisted) French company operating in a so-called "sensitive" sector. Indeed, since the entry into force of the Decree, the number of sectors likely to fall within the scope of "sensitive activities" has continued to grow (aerospace and data hosting, press,

food safety, quantum technologies, energy storage, biotechnologies, technologies involved in the production of renewable energy...).

In addition, the thresholds for triggering the review of equity investments in French companies operating in sensitive sectors have continually been lowered (from 25% to 10% of shares in listed companies until 31 December 2022).

Finally, some temporary measures, which were due to expire at the end of December 2020, have been extended.

In France, the Ministry of the Economy reviewed 328 transactions in 2021, a 31.2% increase when compared with 2020, thus demonstrating its enthusiastic rigour in applying its foreign investment control regime.

In addition, and more globally, foreign investment control has been strengthened at the European level, with the adoption of the Foreign Investment Screening Regulation in March 2019, which has only furthered the importance of looking at these regulations from a multi-jurisdictional perspective. This regulation, which came into force in October 2020, is intended to establish a European framework that enables the European Commission and Member States to coordinate their actions.

The European Commission had already urged Member States to put in place robust foreign investment control mechanisms and to make full use of such mechanisms to protect strategic European assets. In response, 19 of the 27 member states have now adopted foreign-investment regulations, with four member states planning to put regimes in place.

Can foreign investment control be anticipated early along the transaction pipeline? Do investors make use of the possibility of referring a transaction to the authorities at a very early stage?

Emily Xueref-Poviac: The growing importance of foreign investment control in the M&A landscape has been accompanied by a need for investors to be able to anticipate its impact.

For example, the 2019 reform adjusted the foreign investment review procedure to meet this need for deal certainty. In particular, the Decree provides that a French target entity may now make a request for an opinion as to whether all or part of the entity's business falls within the scope of the review to the Minister of the Economy. The Decree also authorises a foreign investor, with the agreement of the French target entity, to make the same request to the Minister of the Economy.

These mechanisms, even if their use has to-date been limited (because they are to be used at a time when the confidentiality of the transaction must be preserved), allow a French target to anticipate foreign investor-related issues upstream of transactions and thus reassure foreign investors about the nature of their activities.

Does this have an impact on the sale procedure or, where a sale is carried out by way of auction, the negotiating position of bidders?

Emily Xueref-Poviac: There are several points to consider when answering this question, as the reform of foreign investment control that came into effect on 31 December 2019 has significantly modified the notion of "foreign investor", which has had a direct impact on bidders.

Prior to the reform, the scope of control varied depending on whether or not the foreign investor was established in a Member State of the European Union or another State within the European Economic Area. The Decree abolished the distinction between European and non-European foreign investors. As of 31 December 2019, the list of sectors classified as sensitive under the foreign investment control regime applies indiscriminately to European and non-European investors – this effectively extends the scope of application of the sectors deemed sensitive to all non-French investors. As a result, bidders are no longer differentiated according to the sector concerned, and many more of them find themselves having to deal with foreign investment regulations.

In addition, the Decree has introduced the "chain-of-control" concept , meaning that the presence of a foreign-investor shareholder is now sufficient to trigger the control procedure, even if the investor is ultimately controlled by a French person or entity. This is an important point, in particular for French investment funds that interpose a foreign holding company in their acquisition structure. Once again, more bidders will have to comply with foreign-investment regulations, since investment funds, even those ultimately owned by a French structure, may now be subject to the same scrutiny as their non-French competitors.

With respect to bidders' respective negotiating positions, it is rare that the need to obtain this authorisation is a determining factor in the choice of a buyer, as sellers generally have good visibility on the assessment of each bidder carried out by the Minister of the Economy and impose obligations on buyers subject to this foreign-investment procedure to agree to any commitments requested by the Minister of the Economy.

Does communication play an important role? Do lawyers take part in these discussions?

Emily Xueref-Poviac: It has become clear that the Ministry will not hesitate to make statements regarding certain projects, as was the case with the proposed takeover of Carrefour by the Canadian company Couche-Tard, which Bruno Le Maire vetoed through the media.

It is, therefore, important to liaise with the Ministry to home in on key issues very early in the process, so as to anticipate potential remedies, or worse, vetoes from the Treasury Department.

Even if a small team, the "Multicom 4" office of the Treasury Department, which is responsible for analysing authorisation requests and managing relations with the inter-ministerial authorities involved and with the European Commission, is still very much available, and willing to listen to practitioners and share thoughts.

As regards communication, the Treasury General Directorate opened a public consultation in March 2022 to pull together stakeholders' views as to the areas where there needs to be clarification of the foreign investment control regulation. Following this consultation, guidelines should then be published to clarify the administrative doctrine of the regime and to help stakeholders better understand the regime from a procedural perspective.

Should, and how should, the risk of being subject to the regime be taken into consideration in the context of due diligence? If so, what role can VDD play in ensuring that a transaction is successful?

Emily Xueref-Poviac: Foreign investment control has become a major issue in M&A transactions, introducing a new dynamic to negotiations with investors. The due diligence stage now plays a key role in securing foreign investments by providing investors with the opportunity to raise questions about the target's business, to structure agreements and to anticipate the impact of the foreign investment control process on the transaction timeline. The questions asked by investors are increasingly sophisticated, their purpose being to establish a set of indicators to determine whether the activity of a target company is likely to fall within the scope of sensitive activities from the point of view of the Minister of the Economy.

How can the potential decisions of the Ministry of the Economy be integrated into the way a transaction is structured?

Emily Xueref-Poviac: As specifically concerns letters of commitment proposed by the Treasury Department, these are confidential and therefore cannot be communicated in full to the foreign investor in question.

As such, once again, the due diligence stage plays an important role in structuring the planned transaction and understanding the impact of previous commitments made, which will most often be transferred by the seller to the buyer.