FOREIGN DIRECT INVESTMENT SCREENING IN FRANCE: THE KEY ROLE PLAYED BY LAWYERS

Interview with Frédéric Bouvet, Managing Partner, Herbert Smith Freehills

Special issue compiled and edited by Marina Guérassimova and Professors David Chekroun, Gilles Pillet (ESCP Business School)

Frédéric Bouvet, Managing Partner at Herbert Smith Freehills in Paris, sheds light on the key role played by lawyers in the foreign direct investment screening process in France.

What is at stake in the screening of foreign investments in France?

Foreign investment, an issue that has only intensified during the pandemic, is now attracting a great deal of attention. According to the latest figures published on the Ministry of the Economy website, in 2020 France was the leading European country in terms of screening foreign investment on its territory.

Despite the health crisis and the significant drop in foreign investment in France (down 17% in 2020), 275 investments were screened in 2020, versus 216 in 2019. In 2021, 328 foreign investment projects were instructed by the French Bureau of Foreign Investment, i.e. a rise of 31.2% compared to 2020. These figures can be attributed to the reform of the system for foreign investment screening that came into force in April 2020, which expanded the sectors affected. The redefined concepts of an investor and an investment operation certainly had something to do with this change as well.

The impact of screening on an operation is hardly trivial: longer time frames to completion, consequences of a prolonged interval between signing and closing for management, risks of having the transaction invalidated or of hefty financial penalties for failing to comply with regulations, effects on the deal and the parties if prior authorisation is not granted, impact on structuring and profitability of the transaction if the French Bureau of Foreign Investment imposes restrictive conditions on the purchaser, etc.

This is why it has become vital to analyse the situation ahead of time, so the procedure can be taken into account as much as possible if it applies.

Why is the lawyer's role so important in the foreign investment process in France?

First, we must remember that, for the time being, there are no doctrines or guidelines that explain the details of screening by the Bureau of Foreign Investment. Moreover since the process is confidential, the Bureau's decisions are not published. And lastly, case law on this topic is relatively rare.

Unlike France, several countries around the world that engage in strict screening have chosen to publish guidelines for foreign investors. Russia, the US, Australia and the UAE have all taken this approach.

In England as well, lawmakers have taken care to hold a public consultation and provide affected business sectors with more precise definitions. A guidance has been published by the UK Government giving further details on the 17 types of notifiable acquisitions under the UK's new National Security and Investment (NSI) Act.

Foreign investors interested in France, however, can only rely on the experience and know-how of their French legal advisors.

Our firm has been developing this practice for many years. An international group of more than 200 lawyers at HSF regularly exchanges information on the latest trends in foreign investment screening, devising and regularly updating an interactive guide to help investors understand the major principles behind different national systems at a glance.

How do you prepare a request for prior authorisation?

Because so much is at stake with foreign investment screening, our clients are consulting us earlier and earlier in the process, while they are structuring the project. There are several stages involved in preparing a request for prior authorisation.

The first is always to weigh up the French investment target against the list of sensitive sectors and applicable law.

This means identifying the affected French assets or businesses in order to determine whether they are strategic. A good understanding of the business sector, technologies, raw materials involved, client base and business partners (especially those in the public sector) is essential. Yet this understanding is not always easy to come by due to the confidentiality of the investment project. The work is complex because the French screening procedure is not triggered by any material threshold. In other words, screening may apply even though only a tiny fraction of the investment is actually strategic. The size, revenue, or profits of the business are not taken into account, nor is the value of the transaction.

The analysis is even more complex because the strategic nature of a business is a very fluid concept, to say the least, especially in times of crisis. Recent events have proved that the Minister of the Economy employs a very broad notion of what counts as a sensitive business sector. As we can see from the Carrefour/Couche Tard case, a mass retailer can now be considered as sensitive for reasons of food security.

The second stage requires a very detailed analysis of the features of the investment operation.

As a reminder, the law covers any type of investment – whether direct or indirect – in which control is acquired over a French corporate entity or branch thereof. For investors from non-EU countries, screening is triggered when they cross a notification threshold of 25% of voting rights – or 10% for French companies listed on a regulated market until 31 December 2022 (please note however that this specific regulation for listed companies may be further extended).

In certain situations, it may be difficult to identify a foreign investment at first sight. This is particularly true of reverse triangular mergers, a common practice in the UK and the US in which a subsidiary of the purchaser is merged into the target. This is also true of certain transactions using securities entitling their holders to future equity in a French company (issuing share equivalents such as convertible bonds, convertible bonds for foreign bearers, put or call options for foreign investors, etc.). In the same vein, the concept of a "business line", which is not defined in any text of law, may raise questions in certain transactions. Is it an autonomous set of assets, a standalone asset, or even a group of employees?

Lastly, the identity and nationality of the investor who is the ultimate beneficiary of the transaction must be determined.

This is often difficult to do for listed companies or for non-European foreign shareholders, as one needs to go back up the chain of control as far as possible. With the reform passed in December 2019, it has also been important to verify that the investor, even if not controlled within the meaning of article L.233-3 of the Commercial Code, is not under the decisive economic, operational or political influence of other, unrelated entities.

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As a result, when dealing with any cross-border transaction, it is now essential to consider from the outset whether foreign investment screening might apply.