IN-DEPTH

Foreign Investment Regulation

EDITION 11

Contributing editors
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LEXOLOGY

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Preface

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In this 11th edition of *The Foreign Investment Regulation Review*, expert practitioners in 25 jurisdictions set out the key elements of foreign investment review and the latest developments in enforcement in their countries. We are delighted this year to include chapters on Australia, Norway and Turkey. This preface incorporates and builds upon the detailed update pertaining to foreign investment developments that we provided in the preface to the 10th edition of this publication.

Unlike systems of merger control, foreign investment regimes often defy simple summary of the thresholds for their application. Typically, the powers of government to review transactions are broad or even substantially unlimited, sometimes focusing on investment in key strategic industries while reserving a general review power for other sectors. In this context, we hope that the jurisdictional summaries at the start of the book – now with more user-friendly navigation in the online version – is a useful tool.

Geopolitical tension continues to increase in prominence as a factor that affects all aspects of international commercial activity. Continuing trade tensions between China and the United States, together with other members of the Five Eyes security sharing network, coupled with concerns about the status of Taiwan, the massive supply chain disruptions emanating from the covid-19 pandemic, the broad continuing consequences of Russia's invasion of Ukraine, and the surge of interest in artificial intelligence and other technologies requiring huge levels of computing power, among many other factors, have all contributed to an increased focus on the regulation of foreign investment.

In consequence, the prevailing trends of enforcement over the past 12 months are the increased scope of foreign investment regulation across countries and the increased intensity of interventions – with a steadily growing number of transactions being subject to remedies ranging from specific corrective orders to outright prohibitions. The concept of national security, which forms the heart of many foreign investment reviews, has generally been broadened far beyond defence and military markets to include many areas where national sovereignty over industrial capability is considered to be essential. These broader sectors include semiconductors and other computer componentry and technology, artificial intelligence, advanced materials, telecommunications, cybersecurity technology, civil nuclear power generation, the mining of critical minerals, other energy production and storage technology, and key transport infrastructure. In addition, essential supply chains, significant environmental investments and certain investments pertaining to sensitive cultural sectors also may become focal points for national interest considerations and related foreign investment reviews.

Examples of these trends are plentiful. In September 2022, US President Biden directed the Committee on Foreign Investment in the United States to take into account a broader US national security policy with a focus on economic security as a key driver of national security, thereby considering US technological leadership in specific areas as part of its review. The Canadian government announced a new policy in October 2022 for national security reviews under the Investment Canada Act, significantly limiting the scope for foreign state-owned enterprises (and private investors with close ties to foreign governments) to invest in Canada's critical minerals sectors and critical minerals supply chains.

In addition, in November 2022, Canada launched its new Indo-Pacific Strategy, which is directed at enhancing security while expanding trade and certain types of investment together with supply chain resilience in the Indo-Pacific region. Developments such as Canada's Indo-Pacific Strategy and the formation of AUKUS (a trilateral pact between Australia, the United Kingdom and the United States) in September 2021, both in relation to the Pacific region, underscore the growing breadth of national security and its potential effects on the expanded scope of foreign investment reviews. That includes a broader array of markets that may be subject to parallel competition reviews. Significant continuing geopolitical considerations pertaining to but not exclusively relating to China and North Korea underlie these evolving developments.

One very recent development is the Canadian government's announcement on 1 September 2023 pertaining to a wide range of new national security measures directed at precluding Chinese government influences on the operations of a bank that is incorporated and based in Canada.

Operation of the United Kingdom's National Security and Investment Act 2021 is now in full swing, with the UK government prohibiting five transactions since 2022, all of which involved investors with links to China or Russia. Interventions in the United Kingdom have not, however, been limited to Chinese or Russian investors, with a further 10 transactions being subject to remedies, including those where the acquirer was linked to allied Western states. Belgium, Italy and the Netherlands have introduced new foreign direct investment and national security screening legislation, while Germany has broadened its definition of the critical infrastructure that is subject to more intense review under its law to include liquefied natural gas terminals and submarine cable landing points. Germany and Italy have both ramped up their enforcement efforts and intervened in several transactions involving Chinese or Taiwanese acquirers.

Japan has strengthened restrictions on foreign investments in broadcasting businesses, while its new screening framework for security-critical infrastructure came onstream in 2023. Somewhat bucking the trend, China, on the other hand, has liberalised its restrictions in a bid to attract foreign investment into advanced manufacturing industries and modern service industries. In particular, the newly introduced flexibility covers areas of renewable energy technologies and products, medical consumables, recycling and energy saving technologies, products and related services.

Related developments have not been limited to regimes to monitor inbound investments. In August 2023, the US government, through an Executive Order of President Biden, gave notice of an intention to introduce restrictions on US companies making outbound investments in relation to certain businesses in China. This Executive Order marks a new departure for US investment control policy. The European Union is also actively discussing the introduction of a new initiative to create a targeted set of outbound investment controls. Japan and China already, to a certain extent, apply outbound investment controls for their companies.

A different, but closely related, development has been the introduction of protections against the distortive effects of foreign subsidies on domestic markets. The EU Foreign Subsidies Regulation is now in operation and grants the European Commission the ability to investigate and enforce against subsidies from non-EU governments in a range of scenarios. A critical part of this new regime is a new filing and approval requirement for transactions that meet the applicable thresholds. The US antitrust agencies have also proposed changes to the requirements of their Hart-Scott-Rodino Act merger filing form to require merging parties to provide information about subsidies from 'foreign entities of concern' that can distort the competitive process or otherwise undermine competition following an acquisition.

It is therefore evident that a detailed understanding of the filing and approval requirements – as well as how to navigate the potential pitfalls – in a potentially large list of foreign investment review regimes has become a critical aspect of international deal planning. There is also a growing potential for developments in one area of review to affect the assessment in the other.

These developments also have been recognised by bar associations and policy institutes internationally. In November 2022, the Organisation for Economic Co-operation and Development (OECD) held the first joint session of the OECD Competition Committee and the OECD Foreign Investment Committee to discuss developments in parallel pertaining to the interface of competition reviews in parallel with foreign investment reviews. Delegations from government bodies across the globe, together with representatives from the business community, participated in that joint session. In addition, in August 2023, the American Bar Association Antitrust Section constituted for the first time a new Committee on Foreign Investment and National Security. The new Committee will focus on the increasing interface of competition reviews and foreign investment reviews, having regard to the evolving breadth of national security issues, especially in relation to the technology sector and the supply of certain essential products. The Committee's mandate is not limited to the United States but rather extends to the evolving interface across the globe. The net effect of these developments is that transaction planners now have to contend, in an increasing number of cases, with significant additional geopolitical, security and national interest considerations together with related regulation going beyond traditional competition law reviews.

In the context of these significant evolving developments, we hope that this publication will prove to be a valuable guide for parties and their legal counsel considering a transaction that may trigger a foreign investment review. This publication provides relevant information about and insights into the framework of laws and regulations governing foreign investment in each of the featured jurisdictions, including the timing and mechanics of any required foreign investment approvals and other jurisdiction-specific practices. The focus is on practical and strategic considerations, including the key steps for foreign investors planning a major acquisition or otherwise seeking to do business in a particular jurisdiction.

This publication examines the emerging issues described above and the recent trends that have continued to evolve, together with their implications. Parties and their legal counsel would be well advised to ensure that they thoroughly understand these issues and, if necessary, engage with regulatory counsel early in the planning process so that deal risk can be properly assessed and managed.

We are thankful to each of the chapter authors and their firms for the time and expertise they have contributed to this publication. We also thank Law Business Research Ltd for its ongoing support in advancing such an important and relevant initiative.

Please note that the views expressed in this book are those of the authors and not those of their firms, any specific clients, or the editors or publisher.

Jurisdictional Summaries

Austria *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	Public policy or national security, including crisis and public services.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Mandatory filing for acquisitions of certain numbers of voting rights or other forms of control in an Austrian undertaking by a non-EU, non-EEA or Swiss investor if the target is active in certain sensitive sectors. • Sanctions for non-compliance include treatment of the transaction as void and criminal and administrative penalties.
What are the review periods?	• Approximately 70 to 80 days for a Phase I review. The authority must decide within one month following conclusion of EU cooperation mechanism proceedings, which typically end approximately 1.5 months after submission of the application. • Another two months for an in-depth Phase II investigation.

Are there thresholds for notification/reviewability?	• Indirect or direct acquisition of:
	  • 10%, 25% or 50% of voting rights;
	  • a controlling interest irrespective of specific shares of voting rights; or
	  • a controlling interest of substantial assets in an Austrian undertaking by a non-EU, non-EEA or Swiss investor if the target is active in a sector considered sensitive from a foreign direct investment (FDI) perspective.
	• No filing requirement if *de minimis* thresholds are not met (i.e., fewer than 10 employees and an annual turnover or an annual balance sheet total of less than €2 million).

Undertakings/commitments and other mitigation measures available to address concerns	• Mitigating measures are not foreseen under Austrian FDI rules. • When evaluating whether there is a threat to national security or public policy, the Austrian authority takes into account whether (1) an acquiring person is controlled directly or indirectly by the government, (2) an acquiring person is or has been involved in activities that have or have had an impact on security or public policy in another EU Member State, and (3) there is a significant risk that an acquiring person is or has been involved in illegal or criminal activities.
Any other important considerations?	• The Austrian regime that entered into force in summer 2020 brought wide-ranging changes and led to a significant increase of mandatory filings in Austria. • The sensitive sectors triggering an FDI filing requirement are very broad, with a focus on pharma, digitalisation and technology. • The Austrian regulator is taking a broad and active approach – also within the EU consultation mechanism. • In comparison with the old regime, the timing to obtain FDI approval has more than doubled to approximately 70 to 80 days for a Phase I review.

Belgium *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	National security, public order and the strategic interests of the federal and federated entities in Belgium.

Belgium *Freshfields Bruckhaus Deringer*	
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Mandatory filing. • Suspensory. • Failure to notify can give rise to fines of between 10% and 30% of the value of the investment in Belgium.
What are the review periods?	• Pre-notification (completeness check): not subject to any statutory timetable. • Phase I (assessment): 30-calendar-day statutory timetable subject to potential extensions and stop the clocks (in case of requests for information (RFIs)). • Phase II (screening): 28-calendar-day statutory timetable subject to potential extensions and stop the clocks (in case of RFIs or remedies negotiations, for instance).
Are there thresholds for notification/reviewability?	• Filing required only for investments by non EU-investors. • Two separate thresholds: (1) 10% voting rights in a Belgian entity active in certain sensitive sectors combined with a €100 million turnover threshold; and (2) 25% voting rights in a Belgian entity active in certain sensitive sectors, including a €25 million turnover threshold for the biotech sector. • The regime captures both de novo acquisitions of stakes exceeding the relevant thresholds and acquisitions of incremental stakes and internal reorganisations.
Undertakings/commitments and other mitigation measures available to address concerns	• When evaluating whether there is a threat to public order, national security or the strategic interests of the federal and federated entities in Belgium, the Belgian Interfederal Screening Commission (ISC) can take into account (1) whether any foreign government entities are involved in the acquisition, (2) whether the foreign investors have already made other acquisitions that were subject to screening, or (3) whether there is a serious risk that the foreign investors engage in any illegal activities. • Types of remedies that are available include (1) a code of conduct for the exchange of sensitive information; (2) appointment of compliance officer(s), who will be in charge of dealing with sensitive information; (3) bundling the sensitive activities in a separate entity to which access and control is limited; (4) appointment of a separate supervisory board; (5) periodic reporting or periodic controls; and (6) limitation on the number of shares that can be acquired.
Any other important considerations?	• The regime applies to foreign investments that were signed on or after 1 July 2023. • The ISC can initiate an ex officio investigation into reportable transactions that have been implemented but that parties have failed to notify up to five years after closing of the transaction. These call-in powers can also be applied to transactions that have been signed prior to 1 July 2023. • The regime does not apply to greenfield investments or asset deals.

China *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	Two separate regimes regulate foreign investment review in China: (1) the foreign investment regime (the FIR regime) and (2) the national security review regime (the NSR regime). The former regime is applicable to all foreign investment activities carried out directly or indirectly by foreign investors in China, while the latter regime applies only to foreign investment that has an impact or is likely to have an impact on national security.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Both the FIR regime and the NSR regime are mandatory. • FIR regime: if a foreign investor invests in a prohibited sector or if a restricted foreign investment does not comply with relevant restrictions, depending on the status of the investment transaction, the foreign investor may be ordered by the authorities to discontinue the transaction, dispose of the shares or assets acquired, or unwind the transaction. • NSR regime: while there is no monetary penalty for failure to notify, the authority may ask the foreign investor to submit a filing and take any necessary actions to address the identified national security concerns, including, but not limited to, divestiture of the acquired shares or assets. • If no correction is made in time, non-compliance will be recorded in the national credit information system and may be subject to disciplinary action with negative impact on the daily operations of the foreign investor's China business.
What are the review periods?	The NSR regime periods are as follows: • 15 working days preliminary review period; • 30 working days general review period; and • 60 working days special review period (which can be extended in special circumstances).

China *Freshfields Bruckhaus Deringer*	

Are there thresholds for notification/reviewability?	• FIR regime: currently 21 industries on the Negative List in relation to which foreign investment is prohibited and 10 restricted industries in relation to which foreign investors should usually team up with Chinese partners and follow certain requirements imposed by the Negative List.
	• NSR regime applies to:
	  • investments in military or military-related industries or investments located near military facilities; or
	  • acquisition of control over a Chinese target active in critical agriculture, critical energy and resources, significant equipment manufacturing, critical infrastructure, critical transportation services, critical culture products and services, critical IT-related or internet products and services, critical finance services, key technologies and other critical sectors. What is considered as 'critical' is not set out in any regulation, leaving broad discretion to the authority.

Undertakings/commitments and other mitigation measures available to address concerns	• If foreign investors fail to comply with investment access restrictions during the transaction stage, they may be required by authorities to rectify their non-compliance before they are allowed to continue the transaction. • Under the NSR regime, both structural and behavioural conditions may be explored if a foreign investment in China attracts national security concerns.
Any other important considerations?	• The new Foreign Investment Law, which took effect on 1 January 2020, contains a number of market-liberalising principles and has established the principle of national treatment for the foreign investments that are not captured by the Negative List. • As regards the NSR regime, during the past two years, there has been greater scrutiny by the Chinese authorities of foreign investments that may impact on national security. For foreign investments falling within covered sectors, the NSR regime will no doubt add complexity and potentially impact on deal timelines. Early identification of likely issues and planning of filing strategies are therefore critical to reduce uncertainties.

Dominican Republic *Guzmán Ariza, Attorneys at Law*	
What is the nature of the review?	National security and public interest.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	Registration of foreign investments with government authorities is not mandatory, nor is state approval required for the repatriation abroad in foreign currency of capital invested or benefits received by investors.
What are the review periods?	Not applicable.
Are there thresholds for notification/reviewability?	• Except in very special circumstances, such as in relation to insurance and telecommunications, foreign investment is not subject to a cap or special screening or requirements. The Insurance Law stipulates a local ownership requirement; therefore, at least 51 per cent of the shareholding participation of local insurance companies must be owned by Dominican citizens. • Similarly, the Telecommunications Law requires that to be a concessionaire of a public broadcasting service, to obtain concessions and the corresponding licences to provide public telecommunications services, the applicant must be incorporated as a legal entity of the Dominican Republic. Furthermore, in the case of public broadcasting services, in addition to the above, the person who has control of the operations and management of the concession company is required to be a Dominican national or a naturalised foreigner.
Undertakings/commitments and other mitigation measures available to address concerns	No undertakings or commitments and other mitigation measures have been taken. Foreign investment in the Dominican Republic is not subject to any prohibitions.
Any other important considerations?	• The Dominican Constitution grants foreign and local investors equal treatment under the law, stating expressly that foreigners in the Dominican Republic are entitled to the same rights as Dominican nationals, except in relation to participation in local political activities. • Correlatively, foreign investors are bound by the same rules and regulations as those applicable to local investors. Shareholders, partners, members, officers and directors of a Dominican company do not need to be Dominican citizens or residents.

France *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	National interest, namely public policy, public security, national defence interest, arms controls.

Is it mandatory to file/wait for approval before closing?
Are there sanctions for non-compliance?
	• Mandatory filing.
	• Suspensive effect.
	• Failure to obtain approval of the Minister of the Economy prior to completion of the transaction may result in the following sanctions:
	  • the parties may be required to apply for prior authorisation, unwind the transaction or modify it;
	  • pecuniary fines of up to twice the value of the investment at stake or 10% of the annual turnover achieved by the target company, whichever is higher;
	  • any agreement implementing the foreign investment without due authorisation from the Minister of the Economy may be deemed null and void; and
	  • criminal sanctions may be imposed on the investor.

What are the review periods?	• Phase I: 30 working days to clear the transaction. • Phase II: 45 additional working days to clear the transaction with or without conditions.

Are there thresholds for notification/reviewability?	• No turnover or value-based thresholds for reviewability.
	• Filing required for non-EU or non-EEA investors when:
	  • an acquisition of control is of a French entity involved in sensitive activities;
	  • an acquisition is of part or all of a branch of a French company involved in sensitive activities;
	  • voting rights in a France-listed company involved in sensitive activities exceeds 10%; or
	  • voting rights in a French company involved in sensitive activities exceeds 25%.
	• Filing required for EU and EEA investors when:
	  • an acquisition of control is of a French entity involved in sensitive activities; or
	  • an acquisition is of part or all of a branch of a French company involved in sensitive activities.

Undertakings/commitments and other mitigation measures available to address concerns	• Typical remedies that could be imposed by the Minister of the Economy include: • ensuring continuity of supply of sensitive products or services to sensitive clients; • maintaining a reasonable level of investment in the target's activities to ensure the continuity of its business; • maintaining an R&D office in France; • maintaining industrial sites in France (e.g., production sites); and • ring-fencing sensitive information, sites or technology to prevent investor access.
Any other important considerations?	• On 9 September 2022, the Ministry of the Economy issued its first guidelines on the regulation of foreign investment control in France. • On 5 January 2023, the Minister of the Economy announced that the temporary 10% threshold relating to investments in listed companies will soon become permanent.

Germany *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	Depending on the applicable review regime, either: • public policy or security in Germany, another EU Member State or projects of EU interest; or • Germany's essential security interests.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Filings are mandatory and suspensory for investments in certain sensitive industry or security sectors (as listed in the Foreign Trade Ordinance (AWV), Sections 55a and 60) if the investor acquires a certain share of the target's voting rights. • Completing a transaction without mandatory pre-approval may result in criminal sanctions for corporations and individuals.
What are the review periods?	• Phase I: two months. • Phase II: four months, extendable by three months if the review entails 'actual or legal difficulties' and by one additional month if the transaction affects defence interests. The Phase II review period starts as soon as the parties comply with the authority's information request for an in-depth review. • Pending information requests and the negotiation of remedies stop the clock.

Germany *Freshfields Bruckhaus Deringer*	
Are there thresholds for notification/reviewability?	There are no turnover or value-based thresholds. (b) Mandatory filings (/b) Filing is mandatory for investments that involve: • the acquisition of 10%, 20%, 25%, 40%, 50% or 75% (depending on the target's activities) of voting rights in the target entity, or an asset transaction that allows the investor to acquire a 'definable part' of the target's business operations or 'all the essential operating equipment' (which can be triggered when acquiring stand-alone intellectual property rights). Voluntary filings May be advisable for investments where either a call-in power exists or there is uncertainty about whether the target operates in one of the sectors listed in AWV, Sections 55a and 60. Call-in powers The Federal Ministry for Economic Affairs and Climate Action (BMWK) can call in investments if: • a non-EU or non-EFTA investor acquires 25% or more of the voting rights in any German target, regardless of the industry sector; or • the BMWK suspects a circumvention of the mandatory filing requirements (e.g., because the investor acquires certain veto rights, information rights or the ability to appoint board members).
Undertakings/commitments and other mitigation measures available to address concerns	It is possible to negotiate commitments (in the form of a public law contract with the BMWK) to mitigate concerns. The commitments may include, inter alia: • ring-fencing sensitive information, technology or operational sites; • maintaining existing sensitive capabilities, contracts and supply relationships; and • notifying the government of future intentions to sell the target.
Any other important considerations?	The analysis can be very complex because of: • the many industry sectors covered by the regime; and • indirect acquisitions involving minor stakes in German targets, which may trigger mandatory filings owing to far-reaching rules on the attribution of voting rights.

India *Shardul Amarchand Mangaldas & Co*	
What is the nature of the review?	• Review of foreign investment in a sector requiring government approval entails evaluation by competent authorities in India. • In case of foreign investment by persons or companies or if a beneficial owner of the investment is situated in or a citizen of a country sharing a land border with India (a restricted country), including investment in a sector under the automatic route, prior government approval from the competent authorities is required.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Foreign investment under the government route or foreign investment from a restricted country (including under the automatic route): prior approval from the competent authority is required before closing. • Additional approvals: (1) foreign investment in certain sectors, such as broadcasting, telecommunications, private security agencies and civil aviation, requires prior security clearance from the Ministry of Home Affairs of the government of India; and (2) foreign investment in certain sectors may require prior approval of a sector-specific authority. • Non-compliance of approval requirements attracts penalties under the Foreign Exchange Management Act, 1999.
What are the review periods?	While a period of 10 to 12 weeks from date of filing the application has been prescribed under the standard operating procedures for disposal of an application seeking government approval, it may take between four and eight months for disposal of an application.
Are there thresholds for notification/reviewability?	• Prior approval is required for foreign investment in sectors under the government route or by foreign investment from a restricted country, irrespective of threshold. • Foreign investment is permitted under the automatic route in certain sectors under a prescribed threshold of foreign investment. • Additionally, there are sector-specific conditions such as investment caps, performance-linked conditions and approval from sector-specific authorities.
Undertakings/commitments and other mitigation measures available to address concerns	To address concerns, foreign investors may seek informal guidance from the Department for Promotion of Industry and Internal Trade of the government of India through industry bodies. If necessary, they can make a formal request for clarification.

India *Shardul Amarchand Mangaldas & Co*	
Any other important considerations?	• Prohibited sectors: foreign direct investment (FDI) is not allowed in sectors such as the lottery business, gambling, trading in transferable development rights, certain real estate activities and sectors not open to private sector investment. • Restricted sectors: some sectors have restrictions on FDI, requiring prior government approval (including the above prescribed thresholds). Examples include the defence, multi-brand retail trading and brownfield pharmaceutical sectors.

Israel *Arnon, Tadmor-Levy*	
What is the nature of the review?	There is no one unified foreign direct investment (FDI) regime. Each sector (including national security, real estate, government tenders, privatised enterprises, communications, energy and finance) is regulated separately.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	Different obligations or sanctions exist for specific sectors or laws.
What are the review periods?	Review periods, where they exist, vary between different sectors or laws.
Are there thresholds for notification/reviewability?	Possibly, but these may depend on the specific FDI limitation imposed on the specific sector.
Undertakings/commitments and other mitigation measures available to address concerns	Possibly, but these may depend on the specific FDI limitation imposed on the specific sector.
Any other important considerations?	FDI limitations may appear not only in legislation or regulations but also in specific licences or concessions. Additionally, any transaction, even if devoid of any FDI limitations, may be examined by the Advisory Committee for National Security Affairs in Foreign Investments.

Italy *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	National security, public interest, security of supply.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• If the transaction falls within the scope of the Italian foreign direct investment (FDI) regime, notification is mandatory. • Administrative fines ranging from a maximum of twice the value of the transaction to a minimum of 1% of the turnover of the undertakings concerned. • No criminal sanctions for individuals, unless the conduct at stake amounts to a crime under a different law.
What are the review periods?	• In relation to the security, defence, transport, telecommunications and energy sectors listed in Regulation (EU) 2019/452, Article 4, Paragraph 1, 45 calendar days for review. If no decision is reached, the acquisition or operation is authorised. This term may be suspended if requests for information are issued (to the notifying parties for a maximum of 10 calendar days; to third parties for a maximum of 20 calendar days), for an overall maximum of 30 calendar days. • In relation to the 5G sector, 30 calendar days for review. If no decision is reached, the operation is authorised. This term may be extended by up to 20 calendar days (if there is a risk to the integrity of networks and their data), which may be further extended (only once) for another period of 20 calendar days (in particularly complex cases) for an overall total maximum of 40 calendar days. This term may be suspended if requests for information are issued to the parties (until a response is received and for a maximum of 10 calendar days) and to third parties (until a response is received and for a maximum of 20 calendar days). • Other EU Member States and the European Commission may submit non-binding observations or an opinion and interact with the Italian government. In these circumstances, this may have the effect of further extending the review period.

Italy *Freshfields Bruckhaus Deringer*	

Are there thresholds for notification/reviewability?	• No turnover thresholds for reviewability.
	• In relation to most sectors (except for security and defence, where minority acquisitions (greater than 3% for listed companies and greater than 5% for unlisted companies) are always subject to a notification requirement, even in the case of an EU or EEA acquirer), the duty to notify under the Italian FDI rules applies to:
	  • EU acquirers, in relation to direct or indirect acquisitions of a controlling interest in the energy, transport, telecommunications, food, healthcare and financial sectors; and
	  • non-EU and acquirers in relation to direct or indirect acquisitions of minority stakes (at least 10% shareholding) in the sectors indicated in Regulation (EU) 2019/452 and when the shareholding thresholds of 15%, 20%, 25% and 50% are exceeded, provided that the value of the acquired stake exceeds €1 million.
	• In relation to the 5G sector, the Italian FDI regime applies:
	  • to acquisitions of assets (including equipment) and the provision of services; and
	  • only to non-EU acquirers.

Undertakings/commitments and other mitigation measures available to address concerns	Typical remedies include: • ensuring quality and security of supply; • appointing an Italian national in certain key strategic functions; • keeping facilities – in particular R&D and production – in Italy; • maintaining any existing cooperation and commitment with Italian and European public institutions; • informing the Italian Prime Minister's Office of proposed transfers of intellectual property rights; • maintaining investments and employee numbers in certain strategic functions (typically R&D); and • restricting the use of governance rights that may block investments in certain strategic areas in Italy.
Any other important considerations?	Other government departments (Ministry of Defence, Ministry of Transport, Ministry of Economic Development, etc.) are involved in the national security assessment.

Japan *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	National security, public policy and public safety, benefit to local economy.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Mandatory and suspensory for investments in designated sensitive industries by foreign investors (pre-closing notifications). • Mandatory but not suspensory for investments outside designated sensitive industries (post-closing reports). • Completing a transaction without mandatory pre-approval may result in criminal fines for corporations and individuals, who may also face imprisonment. • Additional criminal sanctions apply for non-compliance with government recommendations and orders.
What are the review periods?	• For pre-closing notifications: 30-calendar-day initial screening period and possible extension of the suspensory period up to five months. • For post-closing reports: no review period.
Are there thresholds for notification/reviewability?	• No turnover-based thresholds for reviewability. • Value-based thresholds for loans of money to Japanese corporations and acquisition of private placement bonds issued by Japanese corporations. • Dependent on level of control acquired. Mandatory filings • Acquisition of 1% or more of shares or voting rights of listed companies. • Acquisition of shares or equity of unlisted companies from a domestic investor (or a foreign investor if the target company conducts certain 'designated businesses').
Undertakings/commitments and other mitigation measures available to address concerns	No undertakings or commitments or other mitigation measures have ever been taken under the Forex Act in Japan, nor are they explicitly provided for in the Act.

Japan *Freshfields Bruckhaus Deringer*	
Any other important considerations?	If the Minister of Finance and other relevant ministers find that a foreign investment is likely to compromise national security, etc., they may order the foreign investor to change or withdraw the investment. If the foreign investor does not follow the order, the relevant ministers may order the foreign investor to dispose of all or part of the shares or equity acquired through the investment or take other necessary measures.

Netherlands *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	National security; public interest (sector-specific regimes only: healthcare, telecommunications and energy).
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Under the anticipated national security regime and sector-specific regimes, a mandatory filing requirement applies to investments prior to completion, regardless of the nationality of the acquirer. • The regimes applicable to the energy and telecommunications sectors do not have suspensory effect, but the notification must be made at least four months (energy) or eight weeks (telecommunications) prior to completion. • The national security regime and healthcare-specific regime have suspensory effect. • Failure to notify a transaction may result in administrative sanctions for corporations.
What are the review periods?	• National security regime and telecommunications: eight weeks extendable by six months (subject to stop-the-clock). • Energy: four months. • Healthcare: four weeks.
Are there thresholds for notification/reviewability?	• No turnover or value-based thresholds for reviewability. • Notification requirement depends on control rights acquired and local activities of the target or acquirer.
Undertakings/commitments and other mitigation measures available to address concerns	Key mitigation measures include: • maintaining a minimum level of Dutch ownership or board and management appointments; • ring-fencing sensitive information, technology and operational sites; • restrictions on future share, asset and IP transfers; and • maintaining existing sensitive capabilities, contracts and supply chains.
Any other important considerations?	National security screening regime entered into effect on 1 June 2023 with potential retrospective application to transactions completed after 8 September 2020 – the government may 'call in' for review any transactions from this earlier date that have not been subject to formal review under the existing screening regime.

Norway *Advokatfirmaet Haavind AS*	
What is the nature of the review?	• No general FDI regime in place but limited mandatory filing regime under Chapter 10 of the Security Act. • The Norwegian government also has virtually unlimited powers to review any transaction on the grounds of national security interests under Section 2-5 of the Security Act.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Filing is mandatory under Chapter 10 for acquisitions of a 'qualified ownership interest' in a target company that has been brought within the scope of Chapter 10, or the Security Act as a whole, by way of individual decision from the relevant government ministry. • Under new legislation, the filing obligation will also cover targets that have received security clearances under Section 9-3 of the Security Act. • A new standstill obligation has been enacted but is not yet in force. • Under new legislation, which is not yet in force, fines may be imposed for non-compliance.
What are the review periods?	Filings are reviewed by government ministries or the Norwegian National Security Authority, which must notify the acquirer within 60 working days of whether the transaction is cleared or referred to the King in Council (the government) for further review. No statutory review deadline applies to the review by the government.
Are there thresholds for notification/reviewability?	• The ownership threshold for mandatory notification under Chapter 10 is one-third of the shares, which will be reduced to 10% under new legislation not yet in force. Several higher ownership thresholds applicable to increases in existing shareholdings will also be added. • In addition, a filing may be triggered under a qualitative criterion (significant influence over the target company).

Norway *Advokatfirmaet Haavind AS*	
Undertakings/commitments and other mitigation measures available to address concerns	• The King in Council (the government) has the power to block and reverse transactions or clear transactions subject to conditions. • Whether any undertakings or commitments are sufficient to remedy the relevant concerns is at the discretion of the government to decide.
Any other important considerations?	• A law amending the Security Act was adopted by the Norwegian Parliament on 20 June 2023. As indicated above, not all amendments have entered into force at the time of writing. • The amendments include a new pre-clearance prohibition on the disclosure of information that may be sensitive on national security grounds, which will need to be factored into a sales process.

Saudi Arabia *Hammad & Al-Mehdar Law Firm*	
What is the nature of the review?	National security and public interest.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Mandatory to file an online application through the Saudi Ministry of Investment's (MISA) portal to obtain approval prior to incorporation. • Permanent Ministerial Committee for Examining Foreign Investments (CEFI) evaluation of merits of foreign direct investment (FDI) and its direct and indirect impact on the national market. • Foreign investors may not engage in activities prohibited under MISA's Negative List. • Engaging in prohibited activities results in the investors being potentially blacklisted.
What are the review periods?	Typically 30 days from submitting the online application.
Are there thresholds for notification/reviewability?	• All FDIs are subject to screening by CEFI, and FDIs relating to the defence sector are subject to higher scrutiny and national security clearances. • Potential notification to the General Authority for Competition of any pre-completion of acquisitions, joint ventures and mergers in the event that the total annual sales of the participating entities exceed 200,000,000 Saudi riyals.
Undertakings/commitments and other mitigation measures available to address concerns	• MISA ensures that the foreign investor is solvent and is in compliance with local regulations. • Foreign investors may be required to abide by certain minimum capital requirements depending on business activity. • Foreign investors must abide by the employment rates and training of Saudi nationals and certain Saudi shareholding requirements depending on the business sector. • Foreign investors must abide by anti-money laundering and counterterrorism financing policies and regulations.
Any other important considerations?	Ensure that all licences are issued and renewed in a timely manner to avoid any fines imposed by local authorities.

Spain *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	Public policy, public safety and public health.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Mandatory filing requirement if certain criteria are satisfied. • Suspensory regime: prior approval is required to close the transaction. • An investment carried out without the required prior approval (1) is invalid and without legal effect, and (2) the investor may be subject to fines of between €30,000 and the transaction's financial value, plus public or private admonition.
What are the review periods?	• Formal approval procedure: up to three months. • Consultation procedure: up to 30 business days.

Spain *Freshfields Bruckhaus Deringer*	

Are there thresholds for notification/reviewability?	**Foreign direct investment screening mechanism (for non-EU/EFTA investors)**
	Mandatory filing requirement if the investment satisfies the following cumulative criteria:
	• the investment is made by a foreign investor:
	  • a non-EU/EFTA resident; or
	  • an EU/EFTA resident beneficially owned by a non-EU/EFTA resident; and
	• the investment qualifies as foreign direct investment:
	  • the investment results in the investor holding at least 10% of the share capital of a Spanish company; or
	  • the investor acquires control of a Spanish company or part of it (including assets, branches or businesses); and
	• the investment fulfils either:
	  • objective criteria: the target is active in certain 'strategic sectors'; or
	  • subjective criteria: the investor meets certain features.
	
	Temporary regime (for EU/EFTA investors)
	Certain investments by EU/EFTA investors may also trigger a mandatory filing requirement if certain criteria are satisfied under the temporary regime applicable until 31 December 2024:
	• the investment is made by an EU/EFTA investor:
	  • an EU/EFTA resident; or
	  • a Spanish resident beneficially owned by an EU/EFTA resident; and
	• the investment qualifies as foreign direct investment following the same indications as explained above; and
	• the investment fulfils:
	  • the value threshold, which is met if the target is either (1) a listed company in Spain or (2) a private company and the investment is worth more than €500 million; and
	  • the investment fulfils the strategic sectors threshold, which is met if the target is active in a 'strategic sector' in Spain.

Undertakings/commitments and other mitigation measures available to address concerns	Remedies may be imposed on grounds of public policy, security or health. In principle, the remedies could take any form and be adapted to the specific nature of each transaction.
Any other important considerations?	Limited precedents to date and very limited visibility on the remedial action of the Council of Ministers because there is no public access to its decisions.

Thailand *Pisut & Partners*	
What is the nature of the review?	• National security. • Readiness of local businesses to compete with foreign companies.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• A proper foreign business licence is required to be obtained before operating any restricted business in Thailand, unless an exemption applies. • Non-compliance is subject to severe criminal liabilities, including an imprisonment term of up to three years or a fine of up to 1 million baht, or both.
What are the review periods?	Depending on the circumstances, six to nine months is common.
Are there thresholds for notification/reviewability?	50% ownership in general, but certain sectors have a lower threshold.
Undertakings/commitments and other mitigation measures available to address concerns	Forming a joint venture with a local Thai party or seeking an approval from the Board of Investment or the Industrial Estate Authority of Thailand or applying for protection under certain treaties.
Any other important considerations?	The law is aggressively interpreted by the regulator. New rulings are issued regularly on a monthly basis and should be monitored constantly.

Turkey *ACTECON*	
What is the nature of the review?	The foreign direct investment (FDI) notification itself does not trigger a review process.

Turkey *ACTECON*	
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• For all transactions that fall under the regime, filing is mandatory. • The FDI Law does not mandate any pre-notification process. • FDI notification does not trigger a review process and the FDI Law does not stipulate a sanction in cases of failure to notify.
What are the review periods?	The FDI notification itself does not trigger a review process.
Are there thresholds for notification/reviewability?	Under the FDI Law, for an investment to trigger an FDI notification obligation, the investment shall be deemed an FDI, which is defined as follows: • establishing a new company or branch of a foreign company by a foreign investor; and • share acquisitions of a company established in Turkey (any percentage of shares acquired outside the stock exchange or 10 per cent or more of the shares or voting power of a company acquired via the stock exchange).
Undertakings/commitments and other mitigation measures available to address concerns	As the FDI regime in Turkey is an information system rather than a permission and approval system, the competent authority receiving the notification (the General Directorate of Incentive Implementation and Foreign Investment) does not approve or reject the transaction when it receives the FDI notification. Therefore, undertakings, commitments and other mitigation measures are not needed and are not available.
Any other important considerations?	• Sector-specific requirements and notifications are the issues to be considered. In particular, there are sector-specific requirements in the civil aviation, television broadcasting, maritime, real estate, banking and insurance sectors. For completeness, Turkey has a functioning merger control regime. • If the transactions involve an asset purchase, rules regarding real estate purchases should be taken into account.

United Kingdom *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	National security.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Mandatory filing for certain acquisitions of shares or voting rights in 17 industry sectors where pre-approval is required before closing. • Other investments (including in the wider economy and asset transactions) are subject to call-in by the UK government and may be notified voluntarily. • Completing a transaction without mandatory pre-approval may result in civil and/or criminal sanctions for corporations and individuals. • Additional civil and/or criminal sanctions apply for non-compliance with government orders and information requests.
What are the review periods?	• 30 working days initial screening period. • 30 working days assessment period extendable by 45 working days (or longer as agreed with the parties).
Are there thresholds for notification/reviewability?	No turnover or value-based thresholds for reviewability. Mandatory filings Applies to investments that involve: • one of 17 specified industry sectors; • a UK-based entity, or an overseas entity that is active in or supplies goods or services into the UK; and • a (share) transaction that allows the investor's shares or voting rights in the target entity to cross the following thresholds: >25%, >50% or ≥75% of shares or voting rights in the target entity, or acquire voting rights that allow it to pass or block resolutions. Voluntary filings Applies to most other investments bestowing at least material influence over an entity (including levels of control above) or ability to use or control an asset, where there is a UK nexus.

United Kingdom *Freshfields Bruckhaus Deringer*	
Undertakings/commitments and other mitigation measures available to address concerns	The UK government can impose mitigation measures to address concerns. Common measures include: • maintaining a minimum level of UK board or management appointments; • ring-fencing sensitive information, technology or operational sites; • restrictions on future share, asset or intellectual property transfers; and • maintaining existing sensitive capabilities, contracts or supply chains. More recent mitigation measures have included: • introducing controls to avoid US International Traffic in Arms Regulations legislation applying to technology required by the Ministry of Defence for its programmes; and • (in one case) more intrusive government board representation and veto and step-in rights over sensitive defence business.
Any other important considerations?	The regime entered into force on 4 January 2022; however, transactions that have closed as early as 12 November 2020 may be called in for review. Other government departments (such as the Ministry of Defence) may be consulted in the national security assessment.

United States *Freshfields Bruckhaus Deringer*	
What is the nature of the review?	National security.
Is it mandatory to file/wait for approval before closing? Are there sanctions for non-compliance?	• Mandatory filing if the target manufactures, designs, develops or tests critical technology that requires a licence to export to the acquirer, or additionally where a foreign government investor acquires a substantial interest in a target with critical technology, critical infrastructure or sensitive personal data. • Legally, only a filing, not an approval requirement. • Other investments subject to call-in authorities. • Civil fine for parties to the transaction for failure to file.
What are the review periods?	• Declaration: 30 calendar days. • Notice: initial review period of 45 calendar day followed by an investigation period of 45 calendar days if warranted and, if required, a presidential review period of 15 calendar day.
Are there thresholds for notification/reviewability?	• No turnover or value-based thresholds. • The Committee on Foreign Investment in the United States (CFIUS) has jurisdiction over any transaction that could result in foreign control (broadly construed) of a US business, or if it is a TID (technology, infrastructure, data) US business, then also any covered investment in such a business. • A filing is mandated only with respect to a subset of transactions subject to jurisdiction; others can be filed voluntarily.

Undertakings/commitments and other mitigation measures available to address concerns	• CFIUS has authority to seek any remedy necessary to resolve identified national security concerns other than as already provided for in existing law.
	• Mitigation is transaction-specific, but most agreements include some standard terms around maintenance of security policies, a security officer, annual reporting and auditing requirements.
	• Other examples include:
	  • maintaining a minimum level of US ownership or board and management appointments;
	  • ring-fencing sensitive information, technology or operational sites; and
	  • maintaining existing sensitive capabilities, contracts and supply chains.

Any other important considerations?	The scope of what constitutes critical technology subject to the mandatory regime may expand as additional technology may be designated as 'emerging and foundational technology'.

Chapter 1

Australia

Kirsten Webb[1]

Summary

I OVERVIEW

Australia is a stable parliamentary democracy, offering international investors a cost-effective, low-risk and innovative business environment. Traditional sectors such as mining, finance, logistics, agriculture, property and construction, and services industries have all performed well, attracting foreign investment. Australia also offers strong capabilities and opportunities in key growth sectors such as renewable energy, health and aged care, and tourism infrastructure.

The country has free trade agreements (FTAs) with regional partners, including member countries of the Association of Southeast Asian Nations (ASEAN), China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, Singapore and Thailand, as well as Chile, Peru, Mexico and the United States. It is also negotiating additional FTAs, including with the European Union, the Gulf Cooperation Council, India and the Pacific Alliance, as well as the Regional Comprehensive Economic Partnership of 16 nations, which would become the world's largest trading bloc.

In Australia, foreign investment is generally encouraged, but notification and approval by the Treasurer are required for certain types of investments. Foreign investment in Australia is regulated by a framework that includes:

- the Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA);
- the Foreign Acquisitions and Takeovers Regulation 2015 (Cth) (the Regulations); and
- the federal government's foreign investment policy.

Foreign investors in certain industries may also be subject to requirements under the Security of Critical Infrastructure Act 2018 (Cth).

II YEAR IN REVIEW

Since 1 July 2022, the Australian Treasury has published quarterly reports on the regulation of foreign investment in Australia, setting out key performance data concerning the operation of Australia's foreign investment regulatory framework.

The most recent quarterly report available (as at 31 August 2023) was the quarterly report for the period 1 January to 31 March 2023.[2] It reports that in that quarter:[3]

- the number of approved commercial investment proposals (being all investments other than residential real estate) was 272, a decrease of 65 proposals compared with the 337 proposals approved in the previous quarter;
- the quarterly average value of commercial investment proposals for the financial year to 31 March 2023 was A$45.5 billion, compared with A$82.6 billion in 2021–2022 and A$56.8 billion in 2020–2021;
- the United Kingdom was the largest source country for approved commercial investment proposals by value (A$4.2 billion), followed by the Netherlands (A$3.6 billion), the United States (A$3.3 billion), Malaysia (A$2.7 billion) and Canada (A$2.2 billion). China and the Republic of Korea dropped out of the quarter's top 10 sources of investment compared with the previous 1 October to 31 December 2022 quarter top 10 but remain in the top 10 for the 2022–2023 year to date for approved value of commercial investment proposals; and
- the largest target sector for proposed investment for the quarter by value was finance and insurance, with a total value of A$12.5 billion.

Two notable recent decisions involved foreign investment in critical minerals. In July 2023, the Treasurer issued a prohibition order stopping US corporation Austroid Corporation (and its Australian subsidiary Austroid Australia) from acquiring an additional 90.1 per cent of lithium miner Alita Resources (under administration), which would bring its stake to 100 per cent.[4] In February 2023, the Treasurer issued a prohibition order blocking China's Yuxiao Fund, the largest shareholder in heavy rare earth producer Northern Minerals Ltd, from increasing its investment to 19.9 per cent from 9.92 per cent.[5]

III FOREIGN INVESTMENT REGIME

i Foreign investment policy

The Australian Treasurer is the Australian government minister responsible for foreign investment decisions. Depending on the nature of the investment, the Treasurer reviews foreign investment proposals against either 'the national interest' or 'national security' on a case-by-case basis.

The Treasurer can block foreign investment proposals that are contrary to the national interest or national security (as applicable) or apply conditions to the way these proposals are implemented to ensure that they are not contrary to the national interest or national security.

'The national interest' and 'national security' are not defined in the FATA and are able to be given a flexible meaning having regard to all relevant circumstances.

The Australian government typically considers the following factors when assessing foreign investment proposals:

- national security: the extent to which the investment affects Australia's ability to protect its strategic and security interests;
- competition: whether the investment may result in an investor gaining control over market pricing and production of a good or service in Australia or allow an investor to control the global supply of a product or service;
- Australian government policies: whether the investment may have an impact on Australian government tax revenue or other policies, such as environmental objectives;
- the impact on the Australian economy and community: whether the investment (including any proposed post-investment restructure) may have an impact on the Australian general economy and ensure a fair return for the Australian people; and
- the character of the investor: whether the investor operates on a transparent commercial basis and is subject to adequate and transparent regulation and supervision, including consideration of the corporate governance practices of foreign investors.

In assessing foreign investment applications in agriculture, the Australian government typically considers the effect of the proposal on:

- the quality and availability of Australia's agricultural resources, including water;
- land access and use;
- agricultural production and productivity;
- Australia's capacity to remain a reliable supplier of agricultural production, both to the Australian community and to our trading partners;
- biodiversity; and
- employment and prosperity in Australia's local and regional communities.

The Australian government does not specify how it will assess whether an action is contrary to national security or gives rise to a national security concern. However, for the purposes of identifying a national security business, national security is defined to include Australia's defence, security, international relations and law enforcement interests.

The Australian government considers the following additional factors when considering investments by foreign governments and foreign government investors:

- whether the foreign government investor is wholly or partly foreign government owned and whether it operates on a fully arm's-length and commercial basis;
- whether the investment is commercial in nature or whether the investor is potentially pursuing broader political or strategic objectives that may be contrary to Australia's national interest; and
- the size, importance and potential impact of the investment.

ii Laws and regulations

Foreign investment in Australia is regulated by a framework that includes:

- the FATA;
- the Regulations; and

- the federal government's foreign investment policy.

Foreign investors in certain industries may also be subject to requirements under the Security of Critical Infrastructure Act 2018 (Cth).

iii Decision makers, institutions, application process and fees

The Australian Treasury is responsible for the day-to-day administration of the framework in relation to Australian businesses, agricultural land and commercial land proposals. Compliance and enforcement of foreign investment rules regarding residential real estate are administered by the Australian Taxation Office (ATO).

The Foreign Investment Review Board (FIRB) is a non-statutory organisation formed in 1976 within the federal Treasury to provide foreign investment policy advice to the Treasurer and the federal government. The FIRB's advisory role includes assessing investment proposals submitted by foreign interests and making recommendations to the Treasurer on the compatibility of those proposals with government policy and the FATA. FIRB also provides information on the government's policies to prospective foreign investors and potential investors alike.

Foreign investment applications involve lodging an online form and certain additional information. Applications that relate to foreign investment in Australian businesses, agricultural land or commercial land are processed by the Treasury. Applications that relate to foreign investment in residential real estate are processed by the ATO.

A fee is payable at the time of giving a notice or making an application under the Act, and the Treasurer is not required to take any action prior to the fee being paid. The time limit on the making of a decision does not begin until the fee is paid.

Australia's foreign investment legislation applies to investment proposals by foreign persons. A foreign person means:

- an individual who is not ordinarily resident in Australia;
- a foreign government or foreign government investor;[6] or
- any corporation, trustee of a trust or general partner of a limited partnership in which:
  - a foreigner (i.e., an individual not ordinarily resident in Australia, a foreign corporation or a foreign government) has a 20 per cent or more interest; and
  - two or more foreigners have a 40 per cent or more interest in aggregate.

Civil and criminal penalties may be imposed on foreign persons for failing to notify an investment that is subject to Australia's foreign investment laws and for other breaches of these laws.

iv Notification of transactions

Whether prior notification of an investment by a foreign person is required is determined by reference to the type of investor, the type of investment, the nature of the underlying investment and the value of the proposed investment.

The four most important concepts with respect to notification of foreign investment in Australia are a notifiable action, a notifiable national security action, a significant action and a reviewable national security action.

A notifiable action or notifiable national security action is an investment by a foreign person in respect of which notification of the proposed action to the Treasurer is compulsory before that action can be taken. Offences and civil penalties may apply if notice is not given. An action is compulsory notifiable only if it meets certain criteria. A notifiable action or notifiable security action does not necessarily need to be a change in control transaction.

A significant action or reviewable national security action is an investment by a foreign person that does not require notification to the Treasurer before that action can be undertaken. However, under the FATA, the Treasurer has the power (referred to as the call-in power) to make a variety of orders in relation to a significant action or reviewable national security action, including prohibiting a significant action because it is contrary to Australia's national interest or prohibiting a reviewable national security action because it is contrary to national security. Because of this, investors need to decide whether to notify the Treasurer voluntarily that a significant action or reviewable national security action is proposed, in order to receive a no objection letter from the Treasurer (see Section III.vi, below). Once a significant action or reviewable national security action is notified by a foreign person to the Treasurer, the person must not take the action unless it receives a no objection notification or the decision period expires before the Treasurer makes a decision.

Parties may enter into agreements relating to a notifiable action, a notifiable national security action, a significant action or a reviewable national security action prior to the Treasurer's decision. However, such agreements must be conditional upon the Treasurer not prohibiting the transaction.

v Monetary thresholds

In many cases, a foreign person will need to notify the Treasurer of their investment only if the investment meets certain monetary thresholds. The thresholds depend on the type of investor and the action proposed to be taken by that investor.

The monetary threshold investment amounts listed in the table below are current from 1 January 2023 and are indexed annually on 1 January (except where indicated otherwise).

Investor	Action	Threshold: more than
Privately owned investors from FTA partner countries that have the higher threshold[7]	Acquiring a substantial interest[8] in: • an Australian corporation or unit trust; or • a foreign corporation that holds Australian assets or has Australian subsidiaries and that carries on an Australia business (or the parent of that foreign corporation) • Acquiring interests in assets of an Australian business that results in a change in control of the business (or an increase in the interests of a person who already controls the business)	• A$1,339 million (non-sensitive sectors) • A$310 million (sensitive sectors)[9] • For acquisitions of a substantial interest in an Australian corporation or unit trust, the threshold is based on the higher of the total asset value or the total issued securities value for the corporation or unit trust. • For acquisitions of interests in assets of an Australian business, the threshold is based on the value of the consideration for the assets.
	Acquiring an interest of 10 per cent or more in an entity or business that wholly or partly carries on an Australian media business[10]	A$0
	Acquiring a direct interest[11] in an Australian agribusiness[12]	• For Chile, New Zealand and the United States, A$1,339 million • For others, A$67 million (cumulative) (based on the value of the consideration for the acquisition and the total value of other interests held by the foreign person (together with any associates) in the entity)
	Acquiring a direct interest in a national security business or an entity that carries on a national security business or starting a national security business	A$0

Investor	Action	Threshold: more than
Other privately owned foreign investors	Acquiring a substantial interest in: • an Australian corporation or unit trust; or • a foreign corporation that holds Australian assets or has Australian subsidiaries and that carries on an Australia business (or the parent of that foreign corporation) • Acquiring interests in assets of an Australian business that results in a change of control of the business (or an increase in the interests of a person who already controls the business)	• A$310 million (all sectors) • For India, the threshold is A$500 million for the acquisition of a service business in a non-sensitive sector. • For acquisitions of a substantial interest in an Australian corporation or unit trust, the threshold is based on the higher of the total asset value or the total issued securities value for the corporation or unit trust. • For acquisitions of interests in assets of an Australian business, the threshold is based on the value of the consideration for the assets.
	Acquiring an interest of 10 per cent or more in an entity or business that wholly or partly carries on an Australian media business	A$0
	Acquiring a direct interest in an Australian agribusiness	A$67 million (cumulative) (based on the value of the consideration for the acquisition and the total value of other interests held by the foreign person (together with any associates) in the entity)
	Acquiring a direct interest in a national security business or an entity that carries on a national security business or starts a national security business	A$0
Foreign government investors	All direct interests in an Australian entity or Australian business (other than direct interests as a result of the foreign government investor establishing a new wholly owned subsidiary)[13]	A$0
	Starting a new Australian business	A$0
	Acquiring an interest of 10 per cent or more in an entity or business that wholly or partly carries on an Australian media business[14]	A$0

There are separate thresholds for land proposals (see table below).[15]

Investor	Action	Threshold: more than
All investors	Acquiring residential land	A$0
	Acquiring vacant commercial land	A$0
	Acquiring national security land	A$0
	Acquiring an interest in Australian land corporations or trusts if the residential land, vacant commercial land, and mining or production tenements is 10 per cent or more of the entity's total assets	A$0

Investor	Action	Threshold: more than
Privately owned investors from FTA partner countries that have the higher threshold	Acquiring agricultural land (including an interest in agricultural land corporations or trusts holding the same)	• For Chile, New Zealand and the United States, A$1,339 million • For others, A$15 million (cumulative). This threshold is not indexed annually.
	Acquiring developed commercial land (including an interest in Australian land corporations or trusts holding the same)	A$1,339 million
	Acquiring interests of 10 per cent or more in Australian land corporations or trusts	A$1,339 million
	Acquiring mining or production tenements (including an interest in Australian land corporations or trusts holding the same)	• For Chile, New Zealand and the United States, A$1,339 million • For others, A$0
	Acquiring low threshold land (sensitive land)[16]	• For Hong Kong (China) and Peru, A$67 million • For others, A$1,339 million
Other privately owned investors	Acquiring agricultural land (including an interest in agricultural land corporations or trusts holding the same)	• For Thailand, where land is used wholly and exclusively for a primary production business, A$50 million (otherwise, the land is not agricultural land). This threshold is not indexed annually. • For others, A$15 million (cumulative). This threshold is not indexed annually.
	Acquiring developed commercial land (including an interest in Australian land corporations or trusts holding the same)	• For India, A$500 million for non-sensitive land for the supply of services • For others, A$310 million
	Acquiring low threshold land (sensitive land)	A$67 million
	Acquiring interests of 10 per cent or more in Australian land corporations or trusts	A$310 million
	Acquiring mining or production tenements (including an interest in Australian land corporations or trusts holding the same)	A$0
Foreign government investors	Acquiring any interest in land	A$0
	Acquiring an exploration tenement or a mining or production tenement	A$0
	Acquiring interests of 10 per cent or more in a mining, production or exploration entity	A$0
	Acquiring interests in Australian land corporations or trusts	A$0

vi Statutory time frame for decisions

Under the FATA, the Treasurer has a statutory period to consider a formal notification and make a decision for both significant actions or reviewable national security actions voluntarily notified and notifiable actions or notifiable national security actions for which notification is compulsory. If the Treasurer does not make a decision or take action in relation to the proposal within the allowed period, the Treasurer loses the ability to prohibit or impose conditions on the proposed investment under the foreign investment framework. The decision period starts when the correct filing fee has been received by the Australian government.

The decision period is 30 days but may be extended before the end of the decision period:

- on request by the applicant (which it may do to avoid an interim order being made (as explained below)); or
- by the Treasurer, for a period of up to 90 days.

The Treasurer has a period of 10 days after the decision period to notify the applicant of the decision, which may be:

- to advise the applicant that the government has no objection to the foreign investment proposal;
- to advise the applicant that the government has no objection to the foreign investment proposal, subject to specified conditions; or
- to advise the applicant that the government objects to and therefore prohibits the foreign investment proposal.

Prior to the expiry of the decision period, the Treasurer may make an interim order if a proposal is complicated or further information is required. An interim order is published publicly on the Federal Register of Legislation and extends the time frame for the making of a decision by a maximum of 90 days. Once an interim order is made, the applicant is unable to extend the decision period.

In routine cases, a decision is often made within 30 days of lodgement of a notification, and a decision to not object to the transaction is normally granted unless the proposal is judged to be contrary to the national interest or national security.

In circumstances where FIRB and the agencies with which it consults are experiencing large volumes of applications or if the notification relates to a sensitive sector or business or involves investors with broader political or strategic objectives that may be contrary to Australia's national interest or national security, then the time frame to obtain a decision is likely to exceed 30 days.

vii Foreign investment no objection decisions

A foreign investment no objection decision by the Treasurer will specify the permitted action(s), the foreign person(s) to which the decision relates (which may be a foreign corporation that is not yet incorporated or a trustee of a trust that is not yet established) and the time limit for the permitted action(s) to be taken (if the foreign person proceeds with those actions).

The time limit is generally 12 months but can be a longer period approved by the Treasurer. A material variation of an agreement (such as increasing the percentage that a person holds in an entity) can require further approval.

Approval of the transaction may be subject to conditions, and compliance with these conditions is compulsory. These conditions are imposed to satisfy the Treasurer that the transaction is not contrary to the national interest or national security.

The Treasurer also has broad powers to impose conditions, vary existing conditions or force divestment of investments already notified and approved under the FATA, where new factors arise presenting national security concerns. The Treasurer may review a no objection notice, a notice imposing conditions or an exemption certificate previously issued.

IV SECTOR-SPECIFIC REQUIREMENTS

National security businesses – special industry sectors

A foreign person proposing to acquire a direct interest (a 10 per cent interest or more) in a national security business or an entity that carries on a national security business or proposing to start a national security business is a notifiable national security action with a A$0 monetary threshold. Approval must be granted before taking the action, and penalties may apply for a failure to notify.

A business is a national security business if it is publicly known, or if could be known by making reasonable inquiries, that the business:

- is the responsible entity for or holds a direct interest in a critical infrastructure asset under the Security of Critical Infrastructure Act 2018 (Cth);
- is a carrier or nominated carriage service provider subject to the Telecommunications Act 1997 (Cth);
- develops, manufactures or supplies goods or technology that are for (or intended for) a military or intelligence use by defence and intelligence personnel or the defence force or intelligence agency of another country;
- provides or intends to provide critical services to defence and intelligence personnel or the defence force or intelligence agency of another country;
- stores or has access to security classified information; or
- stores, maintains or collects personal information of defence and intelligence personnel that, if accessed, could compromise Australia's national security.

For the purposes of the above test, 'critical infrastructure asset' is very broadly defined. In December 2021, the Security of Critical Infrastructure Act 2018 (Cth) was amended to significantly expand the scope of what is considered to be a critical infrastructure asset to include certain electricity assets, ports, water assets, gas assets, aviation assets, banking assets, broadcasting assets, data storage or processing assets, defence industry assets, education assets, energy market operators, financial market infrastructure assets, food and grocery assets, freight infrastructure assets, freight services, insurance assets, liquid fuel assets, public transport networks and systems, superannuation assets, telecommunications assets, domain name systems and other assets the Minister for the Department of Home Affairs declares critical to Australia's social or economic stability, defence or national security.

V TYPICAL TRANSACTIONAL STRUCTURES

The FATA applies to all foreign investments irrespective of the way they are structured (for example, quasi debt (such as convertible notes) is treated as equity for foreign investment law purposes).

A foreign company may carry on business in Australia either as a branch or through an Australian subsidiary company. To carry on business as a branch, the company must register as a foreign company with the Australian Securities and Investments Commission (ASIC) with a certified copy of the company's certificate of registration and constituent documents. It must provide translations of any documents that are not in English.

It must also have a registered office in Australia and appoint a local agent to represent it. Once registered, the foreign company must lodge copies of its financial statements and comply with notification obligations under the Corporations Act.

A foreign company can establish an Australian subsidiary by registering the new company with ASIC.

A company must have a registered office in Australia and Australia-resident directors (two for public companies and one for proprietary companies). A public company must also have an Australia-resident company secretary; however, this is optional for proprietary companies.

There are no residency restrictions on shareholders and no general minimum capital requirements.

There is currently no requirement under Australian law pursuant to which workforce representatives must be appointed as directors.

VI OTHER STRATEGIC CONSIDERATIONS

The Treasurer consults broadly within the Australian government and its instrumentalities (including the Competition and Consumer Commission (ACCC) and the ATO), state and territory governments and their instrumentalities, national security agencies and authorities with responsibilities relevant to the proposed action. Advice and comments provided by such agencies and entities are important in assessing the implications of proposed actions, particularly their national interest and national security implications.

Importantly, if any of these agencies raise queries or concerns or seek to impose conditions on the transaction, the time frame to obtain a decision is likely to exceed 30 days. For example, if the ACCC has concerns from a competition perspective, the decision will not be made until the concern has been resolved. Although Australia does not currently have a mandatory merger control regime, this process of consultation with the ACCC can operate as de facto mandatory clearance by the ACCC.

VII OUTLOOK

The Register of Foreign Ownership of Australian Assets applies to transactions occurring on or after 1 July 2023. Foreign investors must notify the registrar of a wide range of interests in land, water assets, Australian entities and business assets. They must also notify the registrar if they cease to hold those interests and of certain changes to those interests. The Register is not public but is shared across government departments.

In June 2023, the Australian government announced its critical minerals strategy outlining how it will work with investors and international partners to build a critical minerals processing industry with the aim of Australia being a significant producer by 2030 of raw and processed critical minerals.[17]

That strategy includes the government investing A$57.1 million 'to secure strategic and commercial partnerships to develop new, diverse and resilient supply chains underpinned by critical minerals processed in Australia',[18] including:

- A$40 million in grants 'to support co-investment between Australia and like-minded international partners and critical minerals projects that can help develop end-to-end critical minerals supply chains between Australia and partner countries';
- A$6.65 million 'to increase global critical minerals engagement, which includes detailed analysis for strategic projects to help link our supply chains'; and
- A$6.7 million 'to help Austrade boost international engagement on critical minerals'.

In addition, the 2023–2024 Budget included A$2.2 million over four years for the Treasury to track foreign investment patterns in Australia's critical minerals sector,[19] to inform decision-making under the foreign investment framework and to ensure that foreign investment does not conflict with Australia's national interest or national security.

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Endnotes

1 Kirsten Webb is a partner at Clayton Utz.
2 https://foreigninvestment.gov.au/news-and-reports/news/quarterly-report-foreign-investment-1-january-31-march-2023.
3 Australian Government, Treasury, Quarterly Report on Foreign Investment 1 January to 31 March 2023, pp. 3–5.
4 https://www.reuters.com/article/alita-resources-m-a-china-idUSKBN2Z106R.
5 https://www.reuters.com/article/australia-china-rareearths-idUSKBN2V209R.
6 Generally, foreign government investors include not only a foreign government but also sovereign wealth funds and state-sponsored pension funds and any corporation, trustee of a trust or a limited partnership (the general partner of which is treated as a foreign person) in which a foreign government investor (or foreign government investors from the same country) has a 20 per cent or more interest or in which foreign government investors from two or more countries have a 40 per cent or more interest in aggregate. There is, however, an exception to this 40 per cent rule for certain types of investment funds in which unassociated foreign government investors have 'passive' interests of 40 per cent or more.
7 Agreement countries and regions as at 31 May 2023 are Canada, Chile, China, Hong Kong (China), Japan, Mexico, New Zealand, Peru, Singapore, South Korea, the United States, the United Kingdom and Vietnam, as well as any country for which the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP-11) subsequently comes into force.
8 A person acquires a substantial interest when a foreign person (together with any associates) begins to holds an interest of 20 per cent or more of the entity and for a trust when the foreign person (together with any associates) begins to hold a 20 per cent or more beneficial interest of the income or property of the trust, or, if the person already holds such an interest, the person increases that interest.
9 Sensitive businesses include media, telecommunications, transport, defence and military-related industries and activities, encryption and securities technologies and communications systems, and the extraction of uranium or plutonium or the operation of nuclear facilities.
10 For investments in the media sector, a holding of at least five per cent requires notification and prior approval regardless of the value of investment. In addition to traditional newspaper and broadcast media businesses, for the purposes of the FATA, the media sector includes businesses that provide online access to certain news or current affairs content or content that is predominantly audio or video content.
11 Direct interests include investment in interests (1) of 10 per cent or more of the target investment, (2) of 5 per cent or more of the target investment if the acquirer has entered a 'legal arrangement' relating to the business or (3) regardless of the percentage interest, that allow the investor to influence or participate in the management and control of the target investment or influence, participate in or determine its policies.
12 Agribusinesses are defined by reference to certain classes of the Australian and New Zealand Standard Industrial Classification Codes where the earnings before interest and tax from those businesses exceed 25 per cent of the total earnings of the entity.
13 There is an exemption for acquiring an interest in securities in a foreign entity that has non-material Australian assets (i.e., the Australian asset value is less than 5 per cent of the global asset value, the Australian total asset value is less than A$63 million and none of the assets are of a sensitive business or national security business.
14 https://www.claytonutz.com/about/international-services/doing-business-in-australia/foreign-investment#6.
15 There are detailed definitions of each category of land that are not set out here.
16 Low threshold land includes sensitive land such as mines and critical infrastructure (e.g., an airport or port). It no longer includes land falling under prescribed airspaces unless it is one or more of the kinds of low threshold land.
17 https://www.industry.gov.au/publications/critical-minerals-strategy-2023-2030.
18 Australian Government Critical Minerals Strategy 2023–2030, June 2023, p. 29.
19 Australian Government Budget 2023–24 Budget Measures Budget Paper No. 2, 9 May 2023, p. 54; Australian Government Critical Minerals Strategy 20203–2030, June 2023, p. 29.

Chapter 2

Austria

Stephan Denk, Maria Dreher, Lukas Pomaroli and Iris Hammerschmid[1]

Summary

I OVERVIEW

In 2020, there were two major developments that had a significant impact on the screening of foreign investments in Austria. First, in July 2020, a new regime on foreign investment controls replaced the existing (limited) foreign direct investment (FDI) screening mechanism. Second, Regulation (EU) 2019/452 (the Foreign Direct Investment Screening Regulation) became applicable in October 2020, thereby initiating the establishment of the EU consultation mechanism to strengthen communication among Member State FDI regulators and enhance transparency of relevant foreign investments throughout the bloc.

For almost three years, there have been political discussions in Austria around the necessity of strengthening Austrian controls on foreign investment. While these discussions slowed down during 2019, in the wake of the covid-19 pandemic, they gathered significant pace, bringing with them a shift in focus, which is now mainly on the pharmaceuticals, healthcare, technology and digital sectors.

The result is a new Austrian foreign investment control regime with a significantly expanded scope of FDI controls in terms of both potentially sensitive economic sectors and types of transactions involving Austrian businesses that trigger mandatory FDI filings in Austria. More details on the scope and process are provided below, but it is fair to say that the new Austrian FDI regime is now one of the broadest foreign investment controls in Europe, and the Austrian regulator is taking an active approach to imposing these rules.

II YEAR IN REVIEW

The most notable development over the past years is the entry into force of a completely new foreign investment control regime in Austria in combination with an EU-wide consultation mechanism. Comparing the Austrian FDI controls in place until the summer of 2020 with the current screening mechanisms, it is clear that there are very few similarities remaining. While under the previous FDI regime, in place until July 2020, FDI reviews were limited to the most sensitive sectors (e.g., defence, energy, water and telecommunications) with a 25 per cent (of voting rights) threshold and limited national review, the new regime provides for a comprehensive up-to-date and state-of-the-art foreign investment review. The types of transactions (share and asset deals), the relevant thresholds (from 10 per cent of the voting rights upwards), the range of sensitive sectors, the combined EU-wide and national review process, and the extended timeline are all clear indicators that FDI review in Austria has changed significantly.

These changes to the legal framework in combination with a very active regulator (on a national level as well as within the EU consultation mechanism) have led to a significant increase in Austrian FDI filings in past years, which, in turn, has led to lengthier FDI approval proceedings.

III FOREIGN INVESTMENT REGIME

i Policy

A mandatory FDI filing requirement is triggered if the following four requirements are fulfilled: (1) a non-EU, non-European Economic Area (EEA) or non-Swiss investor (2) acquires a certain amount of voting rights or other forms of control (3) in an Austrian (target) undertaking (4) that is active in certain sensitive sectors.

Austrian (target) undertaking

For the purposes of the Austrian Investment Control Act (ICA), an Austrian undertaking can be defined as any permanent organisation of independent economic activity (even if it is non-profit-making) that has its registered office or headquarters in Austria. A mere branch office of a non-Austrian entity that does not have any legal personality cannot be regarded as an Austrian (target) undertaking.

Foreign investor

To be controlled by the ICA, a direct investment in an Austrian undertaking needs to be made either by:

- a natural person without EU citizenship or without citizenship of an EEA state or Switzerland; or
- a legal entity with its registered office or headquarters outside the European Union, the European Economic Area or Switzerland.

Direct investment

The ICA controls the direct or indirect acquisition of the following undertakings:

- an Austrian undertaking;
- voting shares in such an undertaking;
- a controlling interest in such an undertaking; or
- a controlling interest in substantial assets of such an undertaking.

Micro enterprise exception

The ICA provides for an exception for micro enterprises, including start-up enterprises, with fewer than 10 employees and an annual turnover or an annual balance sheet total of less than €2 million, in which case no authorisation is required.

Mandatory approval requirement

In summary, an FDI requires approval if:

- the Austrian target undertaking is active in one of the sensitive sectors listed in the Annex to the ICA;
- EU and international legal provisions do not preclude the obligation from obtaining an authorisation; and
- a minimum share of the voting rights, or irrespective of specific shares of the voting rights a controlling interest, or a controlling interest in substantial assets, of an Austrian target undertaking is acquired.

ii Laws and regulations

Austrian regulator

In Austria, the Federal Minister for Digital and Economic Affairs (the Austrian regulator) is the competent authority for evaluating and granting investment control authorisations.

Committee for Investment Control

In addition, an advisory council, the Committee for Investment Control (CIC), consisting of representatives from different ministries and sometimes provincial bodies, is established to advise the Austrian regulator on investment control issues. The principal tasks of the CIC are as follows:

- to deal with all matters submitted under the ICA;
- to advise on annual reports that have to be submitted under the ICA;
- to advise on developments in FDI at international, European and national level; and
- to advise on fundamental questions of the implementation of the ICA and the Foreign Direct Investment Screening Regulation.

Relevant law

The relevant legal act is the Austrian Investment Control Act, which became effective on 25 July 2020 (the relevant ICA provisions implementing the European cooperation mechanism came into force on 11 October 2020).

iii Scope

Under the ICA, mandatory FDI filings are triggered by the direct or indirect acquisition of the following undertakings:

- an Austrian undertaking;
- voting shares in such an undertaking;
- a controlling interest in such an undertaking; or
- a controlling interest in substantial assets of such an undertaking.

Relevant voting shares

If the investment constitutes an acquisition of voting shares and the target carries out an activity in a sector that is considered particularly sensitive pursuant to the ICA and listed in Part 1 of the Annex, an authorisation is required if more than 10 per cent, 25 per cent or 50 per cent of the voting shares is acquired. For all other sectors, an authorisation is required if 25 per cent or 50 per cent of the voting shares is acquired. This is designed as a staggered approval model where approval is required each time one of these thresholds is exceeded.

Joint acquisitions

If an acquisition is carried out jointly by several foreign persons, their respective shares of voting rights in the target undertaking are added together.

Controlling interest

As regards asset deals and other instances where a controlling interest is acquired (rather than voting rights), a controlling interest means the possibility of exercising decisive influence over the activity of the Austrian target undertaking, either individually or jointly, through rights, contracts or other means, taking into account all circumstances, even if the minimum share of voting rights required by the ICA is not reached. Pursuant to the ICA, a controlling interest may be exercised in particular by:

- ownership or right of use of all or substantially all of the tangible or intangible assets of a target undertaking; or
- rights or contracts that confer a decisive influence within the meaning of Council Regulation (EC) No. 139/2004 on the control of concentrations between undertakings (the EC Merger Regulation) on the composition, deliberations or decisions of the organs of that undertaking.

iv Voluntary screening

Clearance certificate

In addition to submitting a formal investment control application, an acquiring person or the target undertaking may also submit an application for a clearance certificate. The application must contain – with limited exceptions – almost all the information that is also required for submitting a formal application. Within two months of receipt of the complete application, the Austrian regulator shall issue a clearance certificate by administrative decision, if it is established that the direct investment is not subject to an authorisation requirement. Otherwise, the applicants must be notified that the application will be treated as an application for authorisation and the normal authorisation proceedings will commence. If within two months of receipt of the complete application neither an administrative decision nor notification that the application will be treated as an application for authorisation is served, the clearance certificate shall be deemed to have been granted.

v Procedures

Responsibility for filing an application

If an authorisation is required, either:

- the directly acquiring person or persons; or
- the indirectly acquiring person (depending on whether the acquisition of the Austrian target undertaking is direct or indirect) is obliged to submit a written application to the Austrian regulator.

The Austrian regulator must inform the target undertaking of the application. If the target undertaking becomes aware of an intended acquisition requiring approval and has not been provided with any information about an application, it is obliged to notify the Austrian regulator in writing immediately after having become aware of such an acquisition.

Timing for submitting an application

With regard to timing, an application for authorisation shall be submitted immediately after signing or, in the case of a public offer, immediately after the announcement of the intention to make an offer.

Required information for application

An application for authorisation shall contain the following information:

- the name, address and, if available, telephone number and email address of each acquiring person;
- the name, address and, if available, telephone number and email address of the Austrian target undertaking;
- a precise description of the business activities (including products, services and business transactions) of the acquiring persons and the Austrian target undertaking, including a description of the market in which these business activities are carried out (competitors and market share);
- an indication of the natural or legal person in whose ownership or under whose control each acquiring person is ultimately located (i.e., the ultimate beneficial owner (UBO));
- a detailed description of the planned transaction and the detailed ownership and shareholding structure in the target undertaking;
- the other EU Member States in which each acquiring person and the target undertaking conduct relevant business operations;
- the funding of direct investment and the source of any such funding;
- the anticipated date of completion of the direct investment or on which date it was completed;
- whether the process must also be reported under the EU Merger Regulation;
- the name of one or more persons with power of attorney in Austria for each acquiring person; and
- whether the process has or may have an impact on a project or programme of EU interest within the meaning of Article 8, Paragraph 3 of the Foreign Direct Investment Screening Regulation.

European cooperation mechanism

After receipt of the complete application, the Austrian regulator must – without delay – notify the European Commission to start the European cooperation mechanism. The European Commission and the EU Member States are then provided with the opportunity to submit comments. Comments from one or more EU Member States and an opinion issued by the European Commission shall be taken into consideration under the Austrian authorisation procedure if they are submitted within 35 calendar days of the notification to the European Commission, or within 20 calendar days of receipt of additional information from either the acquiring person or the target undertaking, or notification by the Austrian regulator that it has not been possible to obtain the additional required information. An opinion of the European Commission issued after comments from other EU Member States shall also be taken into account if it is received no later than five calendar days after expiry of these deadlines.

If the European Commission or at least one EU Member State has notified its intention to issue an opinion or comments within 15 calendar days of the notification to the European Commission, a decision on the application may be issued only after expiry of all deadlines for the submission of opinions and comments as described above.

In cases of exceptional urgency, particularly if a potential threat to security or public order requires immediate action or if the process must be carried out quickly for important economic interests, an administrative decision may be issued before the expiry of the time limits provided by the European cooperation mechanism as mentioned above. The European Commission and the other EU Member States must be informed immediately after the exceptional urgency has been established, and the reasons for the urgency must be explained to them.

Austrian authorisation procedure

Within one month of the expiry of the relevant deadline provided by the European cooperation mechanism or in cases of extreme urgency after receipt of the complete application, the Austrian regulator shall:

- determine in an administrative decision that an authorisation procedure is not to be initiated because such a procedure would be contrary to obligations under EU or international law;
- determine in an administrative decision that there are no objections to the acquisition because there is no well-founded suspicion of a threat to security or public order; or
- give notification that an in-depth investigation is to be initiated because a more detailed examination of the impact on security or public order is required.

If neither a decision nor a notification as described above is delivered within the aforementioned period, the authorisation shall be deemed to have been granted. All parties will be notified of the beginning of the one-month period.

In-depth investigations

Within two months of notification of the initiation of an in-depth investigation, the Austrian regulator shall issue an administrative decision to:

- approve the transaction if it does not pose a threat to security or public order; or
- if such a threat exists as a result of the transaction, either grant the authorisation subject to the conditions necessary to eliminate that risk or refuse the authorisation if conditions are not sufficient to eliminate that risk.

If no administrative decision is received within this period, the authorisation shall be deemed to have been granted.

The transaction may not be carried out before these decisions have been issued or the relevant deadlines have expired.

Ex officio proceedings

If the Austrian regulator becomes aware of a process that is subject to an authorisation obligation for which no application for authorisation has been submitted, it shall request the acquiring person or persons to submit an application within three working days. If none of the acquiring persons complies with this request within this period, the Austrian regulator shall initiate an *ex officio* authorisation procedure and inform the acquiring persons of this initiation. If the transaction has already been completed in whole or in part and if it is established that there is a well-founded suspicion of a threat to security or public order, the administrative decision shall prescribe conditions that deal with the elimination of the threat. If conditions are not sufficient to eliminate the threat, the notice shall order the unwinding of the entire process or the completed parts thereof.

Threat to security of public order

When assessing whether an FDI may lead to a threat to security or public order, including crisis management and services of general interest, its effects in the areas listed in the Annex to the ICA will be examined by the Austrian regulator. When assessing such a possible threat, particular account shall be taken of whether:

- an acquiring person is controlled directly or indirectly by the government, including government agencies or the armed forces of a third country, inter alia, by means of ownership structure or in the form of substantial financial resources;
- an acquiring person or a natural person who holds a senior position in an acquiring legal entity is or has been involved in activities that have or have had an impact on security or public order in another EU Member State; and
- there is a significant risk that an acquiring person or a person who holds a management position in an acquiring legal entity is or has been involved in illegal or criminal activities.

vi Prohibition and mitigation

While there are no official statistics on the number of transactions subject to review and any prohibited or conditionally approved transactions in Austria, the number of transactions under review has significantly increased over past years and reached an all-time high in the summer of 2021.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

While there are no sectors under the ICA in terms of economic sectors in which foreign investment is per se prohibited, there is a broad catalogue of restricted sensitive sectors.

ii Restricted sectors

The ICA distinguishes between two types of sensitive sectors that are listed in the Annex to the ICA.

Part 1 of the Annex to the ICA lists particularly sensitive sectors where the acquisition of 10 per cent of the voting shares triggers a mandatory FDI filing. The list is exhaustive and includes the following sectors:

- defence equipment and technologies;
- operation of critical energy infrastructure;
- operation of critical digital infrastructure, in particular 5G infrastructure;
- water;
- operating systems guaranteeing the data sovereignty of Austria; and
- research and development in the fields of pharmaceuticals, vaccines, medical devices and personal protective equipment.

Part 2 of the Annex to the ICA includes other sensitive sectors where a threat to security or public order, including crisis management and services of general interest, may arise. The list is illustrative only (meaning that the Austrian regulator could also control sectors or items that are not listed) and includes sectors relating to:

- critical infrastructure;
- critical technologies;
- security of the supply of critical resources;
- access to sensitive information, including personal data, or the ability to control such information; and
- freedom and plurality of the media.

The sectors listed in Part 2 of the Annex to the ICA are as follows:

- critical infrastructure (institutions, systems, facilities, processes, networks or parts thereof); these include, in particular:
  - energy;
  - information technology;
  - traffic and transport;
  - health;
  - food;
  - telecommunications;
  - data processing or storage;
  - defence;
  - constitutional institutions;
  - finance;
  - research institutions;
  - social and distribution systems;
  - chemical industry; and
  - investment in land and buildings essential for the use of the infrastructures referred to in the bullet points above;
- critical technologies and dual-use goods as defined in Article 2, Paragraph 1 of Council Regulation (EC) No. 428/2009, including:
  - artificial intelligence;
  - robotics;
  - semiconductors;
  - cybersecurity;
  - defence technologies;
  - quantum and nuclear technologies;
  - nanotechnologies; and
  - biotechnologies;
- security of the supply of critical resources, including:
  - energy supply;
  - supply of raw materials;
  - food supply; and
  - supply of medicines and vaccines, medical devices and personal protective equipment, including research and development in these areas;
- access to sensitive information, including personal data, or the ability to control such information; and
- freedom and plurality of the media.

Pursuant to the ICA, infrastructures are critical within the meaning of item (a), technologies within the meaning of item (b) and resources within the meaning of item (c), if they are of essential importance for the maintenance of important social functions because their disruption, destruction, failure or loss would have serious effects on the health, safety or economic and social well-being of the population or the effective functioning of government institutions.

V TYPICAL TRANSACTIONAL STRUCTURES

Foreign entities seeking to set up new facilities or businesses and carry out mergers and acquisitions in Austria should take into account the following legal considerations from a foreign investment review perspective:

- the United Kingdom (including all British overseas territories) is now considered a foreign investor under the ICA, so UK investors acquiring companies in Austria may require FDI approval;
- while this has previously not been entirely clear and not specifically regulated, the ICA now specifies that share and asset deals may trigger a mandatory FDI filing if the other criteria for a filing are met;
- generally, internal reorganisation measures within a group can be subject to FDI review if such reorganisation is executed in a sensitive sector; and
- even if the direct transaction is executed via an EU, EEA or Switzerland-based vehicle, foreign investment approval may be required if the UBO is located outside the European Union, the European Economic Area or Switzerland.

VI OTHER STRATEGIC CONSIDERATIONS

Other strategic considerations potentially relevant to foreign investments in Austria include the following:

- while there is no established communication channel between the Austrian merger control and FDI authorities and investment control applications are not published, these two authorities may communicate, and we have been made aware that they regularly exchange information. Investors should therefore be aware that transactions in relation to which merger control filings are made may also be scrutinised from an FDI perspective;
- the FDI regulators throughout the European Union – particularly in Western European jurisdictions – seem to communicate and update each other, in particular through the EU FDI consultation mechanism. This increase in transparency has led to an increased number of requests for information from other EU Member State FDI regulators and, as a result, more filings; and
- in recent experience, transactions in the pharmaceuticals and healthcare sectors and generally transactions involving foreign sovereign wealth funds or other state-owned entities have been subject to particularly thorough screenings to ensure that there is no threat to public order or security, or both.

VII OUTLOOK

Looking forward, it seems likely that the Austrian regulator will continue its active approach, which will keep the number of FDI applications at a high level. We expect the Austrian regulator, as well as applicants, to use the experience gained over past years and to determine that certain transactions, although touching upon sensitive sectors, do not actually trigger mandatory approval requirements. It further seems likely that the timeline for approvals will stabilise in the coming year.

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Chapter 3

Belgium

Tone Oeyen and Marie de Crane d'Heysselaer[1]

Summary

I OVERVIEW

Regulation of inbound foreign investment has traditionally been very limited in Belgium. Since 2018, the Flemish Region, or Flanders, has had a limited foreign investment control regime, providing for a type of 'emergency brake' procedure for strategic investments into Flemish government-owned entities. The regime allows the Flemish government to annul or declare void any foreign investment that would threaten the strategic interests or the independence of Flanders.

Until recently, Belgium was one of the few remaining EU Member States that did not have a country-wide foreign investment screening mechanism (and had therefore not yet responded to the European Commission's March 2020 call incentivising Member States to set up a foreign investment screening mechanism). However, on 1 July 2023, a new Belgian foreign investment screening regime entered into force. The new mandatory general and suspensory regime captures transactions in a broad range of industry sectors involving acquirers established outside the European Union.

The purpose of the new regime is to safeguard national security, public order and the strategic interests of Belgium's federal and federated entities. Strategic interests are defined as the interest of each entity (1) to ensure the continuity of vital processes, (2) to avoid certain strategic or sensitive information being accessed by foreign actors and (3) to ensure strategic independence.[2]

II YEAR IN REVIEW

The most notable development over the past year has been the entry into force, on 1 July 2023, of the law introducing a mandatory general and suspensory foreign investment screening mechanism in Belgium. All transactions that have been signed on or after 1 July 2023 and that meet the criteria set out by the new regime will need to be notified to a newly established Interfederal Screening Commission (ISC).

On 30 June 2023, the Belgian Ministry of Economic Affairs published draft guidelines aimed at clarifying certain areas of the new regime (the Draft Guidelines). They were drafted as a dynamic document and may be updated from time to time as new questions arise and decisional practice develops.[3]

To our knowledge, the Flemish government has not yet used its foreign investment review powers.

III FOREIGN INVESTMENT REGIME

i Policy

The purpose of the new regime is to safeguard national security, public order and the strategic interests of Belgium's federal and federated entities.[4] As noted above, these strategic interests are defined as the interest of each entity in ensuring the continuity of vital processes, avoiding certain strategic or sensitive information being accessed by foreign actors, and ensuring strategic independence, within the material scope of each entity's competence.[5]

ii Laws and regulations

The principal source of legislation is the cooperation agreement of 30 November 2022 between the Federal State, the Flemish Region, the Walloon Region, the Brussels-Capital Region, the Flemish Community, the French Community, the German-speaking Community, the French Community Commission and the Common Community Commission to establish a foreign direct investment screening mechanism (the Cooperation Agreement). The Cooperation Agreement was incorporated into law by the adoption by the Parliaments of each of the federal and federated entities of assenting laws and decrees.

The Cooperation Agreement sets out the substantive and procedural rules of the new regime and creates the new ISC, which is in charge of screening acquisitions by foreign investors in Belgian entities that meet the thresholds set out in the Cooperation Agreement and that are active in certain sectors considered to be critical. The key aspects of this new regime are outlined below.

In addition, the Draft Guidelines prepared by the Belgian Ministry of Economic Affairs and published on 30 June 2023 clarify certain areas of the new regime.

The Flemish government (acting through the Flemish Prime Minister) is the authority responsible for exercising the specific Flemish foreign investment review powers.

iii Scope

The new regime applies to investments by foreign investors into Belgian entities active in certain sectors that meet certain thresholds and that have been signed on or after 1 July 2023.

Foreign investor

A foreign investor includes (1) every natural person whose main residence is outside the European Union, (2) every undertaking that is established outside the European Union and (3) every undertaking whose ultimate beneficial owner (UBO) has its main residence outside the European Union.

In contrast to the regimes in certain other Member States, the Belgian regime does not capture investments by investors established in the European Union. However, the new regime applies to investments by investors established in the United Kingdom, Switzerland and other non-EU countries.

Thresholds

The new regime captures both direct and indirect acquisitions. This means that even acquisitions that are not happening at the level of the Belgian entity but where the ownership over the Belgian entity indirectly transfers as a result of a transfer higher up in the corporate organisation are notifiable if the relevant criteria are met.

Investors also have an obligation to notify if the investment is acquired in a 'passive manner', such as through an inheritance.[6] Greenfield investments or investments aimed at exercising a direct economic activity by a foreign investor (through the establishment of a subsidiary) are outside the scope of the new regime.[7]

The new regime provides for the below two separate thresholds (irrespective of whether this results in the foreign investor acquiring control within the meaning of the EU Merger Regulation). The list of sectors that is covered by either threshold is exhaustive. A notification will be triggered even if the activities of the Belgian target entity in (one of) these strategic sectors is ancillary to its main business.

Threshold 1[8]

Threshold 1 applies to direct or indirect acquisitions of 10 per cent or more of the voting rights of an entity established in Belgium that is active in the following sectors: defence, including dual-use goods; energy; cybersecurity; electronic communication; or digital infrastructure, provided that the turnover of that entity in the preceding financial year exceeded €100 million.[9]

Threshold 2[10]

Threshold 2 applies to direct or indirect acquisitions of 25 per cent or more of the voting rights of an entity established in Belgium that is active in the following sectors,[11] irrespective of the size of the target or the turnover the target generates (except for investments in certain sectors, as specified below):

- critical infrastructure (including energy, transport, water, health, electronic communications and digital infrastructures, media, data processing or storage, aviation, aerospace, defence, electoral or financial infrastructure, and sensitive facilities), as well as land and real estate critical for the use of such infrastructure;
- technologies and raw materials of essential importance to:
  - safety, including health safety;
  - defence and public security;
  - military equipment subject to the 'Common Military List'[12] and national export control;
  - dual-use goods; and
  - technologies of strategic importance (e.g., artificial intelligence, semiconductors, robotics, cybersecurity, aerospace, defence, energy storage, and quantum and nuclear technologies and nanotechnologies);
- the supply of critical inputs, including in relation to energy, raw materials and food security;
- access to sensitive information, including personal data, or the ability to control such information;[13]
- private security;
- the freedom and pluralism of media; and
- technologies of strategic interest in the biotech sector provided that the turnover of the target exceeded €25 million in the previous financial year.

The regime captures both de novo acquisitions of stakes exceeding the relevant thresholds and acquisitions of incremental stakes. For example, when a foreign investor already holds a 20 per cent stake in a Belgian entity active in a sector considered to be strategic and subsequently acquires a further 5 per cent, a filing will be triggered.[14]

The regime also covers internal reorganisations if the other criteria are met. This means that internal reorganisations for which there is ultimately no change of control may be captured by the regime.[15]

iv Voluntary screening

The new regime prescribes a mandatory and suspensory notification obligation for investments that meet the relevant thresholds. It does not foresee a separate voluntary screening mechanism.

v Procedures

Timing and notification form

All transactions that were signed on or after 1 July 2023 and that meet the other criteria of the regime need to be notified to the ISC. Foreign direct investments that fall within the scope of the regime need to be notified and reviewed by the ISC prior to closing (i.e., the regime is suspensory).[16]

The ISC is composed of 11 members: three representatives of the Federal State, three representatives of the Regions (the Flemish Region, the Walloon Region and the Brussels-Capital Region) and five representatives of the Communities (the Flemish Community, the French Community, the German-speaking Community, the French Community Commission and the Common Community Commission).[17] The Flemish Community can appoint an additional representative for cases linked to competences from the Flemish Community Commission in the Brussels-Capital Region).[18]

The ISC is chaired by a representative of the federal Ministry of Economic Affairs, but the chairperson has no vote in the decision-making.[19] The secretariat of the ISC is organised by the Ministry of Economic Affairs. The ISC currently operates with six full-time employees.

In principle, a notification should be made on the basis of the signed transaction documents, but parties are also allowed to submit a notification based on draft transaction documents, provided that they explicitly declare that they intend to come to a final agreement on all material points that will not differ substantially from the notified draft.[20] Special provisions apply to foreign investments into listed companies.[21] The Cooperation Agreement lists the information to be included in the notification,[22] such as:

- the ownership structure of the foreign investor (including the identity of the investor, its capital participation and its UBO);
- the value of the investment and accompanying valuation considerations;
- the products, services and activities of (1) the foreign investor, as well as its controlling and controlled entities, and (2) the target;
- the Member States and third countries in which (1) the foreign investor, its controlling and controlled entities and (2) the target are active;
- the means used to finance the foreign investment and the source of that financing; and
- the expected closing date of the transaction.

This is reflected in the notification form that is available on the ISC's website. Notifications can be submitted by letter, by email or in person.

Review process

The regime provides for three different phases in the review process. The standard of review is the same in Phase I and Phase II. The competent members of the ISC assess whether (1) the control acquired over a Belgian entity through the notified transaction or (2) the main characteristics of the foreign investor could have an impact on public order, national security or other strategic interests.[23] In their review, they can take account of (among other things) whether any foreign government entities are involved in the acquisition, whether the foreign investors have already made other acquisitions subject to screening or whether there is a serious risk that the foreign investors engage in any illegal activities.[24]

Phase 0 (pre-notification)

The secretariat of the ISC analyses the notification and determines whether the filing is complete. During this phase, the secretariat can request additional information from the foreign investor or any other interested party.[25] The Phase 0 discussions are not subject to any statutory timetable. During the pre-notification phase, no assessment is made on the reportability of a notified transaction.

Phase I (assessment)

Once the notification is deemed to be complete by the secretariat, it is assigned to the competent members of the ISC and the Coordination Committee for Intelligence and Security (CCIS). This implies that not every one of the 11 members of the ISC reviews each notified transaction, rather only those members for whom the envisaged investment has a territorial connection and a link with their areas of competence.[26] The territorial connection is not determined solely on the basis of the location of the headquarters of the Belgian entity that is acquired but is interpreted broadly. If the entity has economic activities in a certain region, or infrastructure or real estate, this is also likely to trigger the competence of the relevant region or community where those activities or assets are located.[27] The members of the ISC who are not deemed competent to review the transaction by the secretariat are provided with a summary of the notification, on the basis of which they may request to review the full notification if they deem it to fall within their competence.[28]

The ISC informs the notifying parties that their notification has been deemed complete. This serves as the notification date on which the statutory review period starts to run.[29]

The actual assessment of the investment is carried out by each of the competent members of the ISC separately, within their own sphere of competence. The secretariat is responsible for coordinating these parallel reviews.[30]

The competent members of the ISC have the option to request the advice of other government entities in the course of their review.[31] However, prior advice from the CCIS is mandatory for each notification.[32] Government entities whose advice has been requested are granted a maximum of 25 calendar days to provide their advice.[33] The ISC members can also appoint individuals to serve as experts if the technicalities and complexity of the transaction so require.[34]

The ISC members can request additional information from the notifying parties, which shall be provided to the ISC without delay. Requests for information suspend the review period.[35] Failing to provide the requested information can expose the parties to administrative sanctions.

If one of the competent members of the ISC considers there to be concrete indications that the notified transaction could possibly threaten national security, public order or the strategic interests of the federated entities, the transaction is referred to Phase II.[36] A Phase II is also opened if the CCIS requests an extension of its review period unless the competent members of the ISC reach a consensus to reject such a request. This request must be justified by the complexity of the investigation.

The transaction is cleared at Phase I if none of the competent members of the ISC reviewing the transaction raises any concerns,[37] or if the review period has lapsed without any decision having been taken and provided that the parties did not provide incomplete or misleading information.[38]

The competent members of the ISC have to complete their review of the notified transaction within 30 calendar days.[39] However, in practice, the timeline can be extended, as requests for advice from other government entities and requests for information to the parties stop the clock.

Phase II (screening)

The Phase II screening builds upon the results of the Phase I investigation and involves a more concrete risk assessment.[40] During this phase, the competent members of the ISC reviewing the transaction can also request advice from other government entities and information from the parties.

On the day that the transaction is referred to Phase II, the secretariat also informs the European Commission and the EU Member States, which will have up to 35 calendar days to share their comments, pursuant to EU Regulation (EU) 2019/452 establishing a framework for the screening of foreign direct investments into the Union. The comments of the other EU Member States are not binding

At the end of this phase, each competent member of the ISC issues an advice for the competent federal, regional or community ministries they represent, within 20 calendar days of the opening of the Phase II investigation.[41] This deadline can be extended by two months (and possibly an additional one month) at the request of the CCIS, unless this request is unanimously rejected by the competent ISC members, provided that this extension is justified by the complexity of the case.[42]

If one of the competent ISC members believes that the notified transaction could have an impact on public order, national security or other strategic interests, a draft advice is first shared with the notifying parties, prior to the issuance of a formal advice to the competent ministries.[43] The parties are, in that case, also able to access the ISC's file.[44] Parties have 10 calendar days to provide their written comments on the draft advice,[45] after which a hearing is organised within 10 calendar days of receiving the parties' comments.[46] These time limits suspend the 20-day deadline mentioned above within which the ISC members have to issue an advice to the competent ministries they represent.[47]

The parties can negotiate remedies with the competent ISC members.[48] These remedy negotiations suspend the 20-day deadline within which the ISC members have to submit advice to the competent ministries they represent for one month (which can be extended for an additional month at a time).[49] Examples of the types of remedies that the ISC can propose include (1) agreeing to a code of conduct for the exchange of sensitive information; (2) the appointment of compliance officers, who will be in charge of dealing with sensitive information; (3) bundling the sensitive activities into a separate entity, access to or control of which is limited; (4) the appointment of a separate supervisory board; (5) periodic reporting or periodic controls; and (6) limitations on the number of shares that can be acquired. This list is not exhaustive.

Based on the advice from the ISC members, each competent federal, regional or community ministry has to adopt a preliminary decision within six calendar days of receiving the formal advice.[50] The ISC combines the preliminary decisions of each individual competent federal, regional or community ministry into one consolidated decision.[51] If more than one federated entity is competent to review a transaction (which is often the case), then that transaction can be blocked only if all competent federated entities agree on its inadmissibility, notwithstanding the unique power of the Federal State to block a transaction that falls within its competences.[52] The ISC secretariat notifies the parties of the consolidated decisions within two calendar days of receiving the preliminary decisions of each individual, competent federal, regional or community ministry.[53] The basis statutory review period for completion of the Phase II screening is 28 calendar days, but this can be suspended or extended in several circumstances, as set out above (e.g., remedy negotiations, complexity of the review, access to file, organisation of a hearing and CCIS's requests for extensions). As a result, the Phase II screening is expected to take between one month (no issues) and four months (a complex review with remedy negotiations) to complete.

Appeal

All final decisions regarding the admissibility or inadmissibility of a foreign direct investment can be appealed before the Market Court, a specific section of the Brussels Court of Appeals, by the parties to the transaction only.[54] The Market Court does not have plenary jurisdiction when reviewing the decision of the ISC: it cannot substitute its own decision for the decision of the ISC; rather, it can merely send the decision back to the ISC if it decides to annul the ISC's original decision.[55] However, the Market Court does have plenary jurisdiction over the fining decisions of the ISC: it can decide to annul, increase or decrease a fine.[56] An appeal does not suspend the ISC decision.[57]

vi Prohibition and mitigation

As the regime only recently entered into force, there have not been any cases of prohibition or mitigation in the past year.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

The regime does not provide for any prohibited sectors.

ii Restricted sectors

As outlined above, investment in certain sectors is subject to the mandatory screening mechanism since the entry into force of the new regime. Separately, foreign investment in Flemish government-owned entities that would threaten the strategic interests or the independence of the Flemish Region or the Flemish Community may be subject to *a posteriori* review by the Flemish government.

V TYPICAL TRANSACTIONAL STRUCTURES

Only acquisitions of voting rights above certain thresholds are captured by the new regime. The new regime will apply to direct and indirect acquisitions of voting rights by non-EU investors, and the ISC will review the corporate chain up to the level of the ultimate entity or person. The new regime does not exempt internal reorganisations. The ISC's initial position was that asset deals would not be captured by the regime. However, the ISC's position in this respect appears to be evolving, and further guidelines about the types of asset deals that may be caught by the regime are expected in due course.

VI OTHER STRATEGIC CONSIDERATIONS

At the request of one of its members, the ISC can decide to initiate an *ex officio* screening procedure of transactions that were not proactively notified if (1) the parties failed to notify a foreign investment that meets the mandatory notification requirements[58] and (2) a screening is deemed necessary to safeguard public order, national security or other strategic interests (even if the notification thresholds are not met).[59] At the end of an *ex officio* investigation, the ISC can decide to impose structural shareholding and governance changes or other remedies for a period of two years following closing. If bad faith has motivated a failure to notify, these measures can be extended for up to five years.[60] If the transaction has been signed before 1 July 2023 (and is therefore, in principle, outside the temporal scope of the new regime), an *ex officio* investigation can also be opened within two years of closing and within a period of up to five years in cases of bad faith.[61]

Investors may face fines of between 10 and 30 per cent of the value of the investment in the event that they fail to notify a reportable investment or provide incorrect or misleading information.

Fines of up to 10 per cent of the foreign investment can be imposed[62] in the following situations:

- failure to provide the necessary information or providing incomplete information in the notification form or in the reply to a request for information, or failure to provide such information within the set deadline;
- when the parties proactively notify a reportable foreign investment that has already been implemented, provided that they do so within 12 months of closing; and
- when the ISC decides proactively to open an investigation into a reportable foreign investment that has been implemented for less than 12 months.

Fines of up to 30 per cent of the foreign investment can be imposed in the following situations:[63]

- when the parties proactively notify a reportable foreign investment that has already been implemented more than 12 months following closing;
- when the ISC decides proactively to open an investigation into a reportable foreign investment that has already been implemented for more than 12 months;
- the provision of incorrect or misleading information in the notification form or in response to a request for information;
- failure to comply with the standstill obligation while the ISC is reviewing the foreign investment; and
- failure to comply with the remedies imposed.

The ISC will notify the parties of its intention to impose a fine and they will be given the opportunity to submit their written comments on this decision.[64]

VII OUTLOOK

As the regime has only recently entered into force, it remains to be seen how it will be applied in practice. In particular, given the broadly defined sectors that are captured by the regime and the ISC's position that it expects parties to notify transactions when they are in doubt about their notifiability, it is unclear how many transactions will be notified to the ISC for review and whether the ISC will be sufficiently staffed to handle the inflow of notifications.

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Endnotes

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2 Article 1, §2 of the Cooperation Agreement.
3 Draft Guidelines available at screening-richtlijnen-filtrage-lignes-directrices.pdf (fgov.be).
4 Article 1, §2 of the Cooperation Agreement.
5 Article 2, 6° of the Cooperation Agreement.
6 Article 5, §1 of the Cooperation Agreement.
7 Article 4, §4 of the Cooperation Agreement.
8 Article 4, §2, 1° of the Cooperation Agreement.
9 The relevant turnover is the turnover of the Belgian entities that are within the scope of the investment and not only the turnover relating to the activity that is considered to be 'strategic'.
10 Article 4, §2, 2° of the Cooperation Agreement.
11 They concern similar sectors to those identified in Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union.
12 The Common Military List of the European Union adopted by the Council on 17 February 2020 concerns equipment covered by Council Common Position 2008/944/CFSP defining common rules governing the control of exports of military technology and equipment.
13 Sensitive information is defined in the Cooperation Agreement as any information the disclosure of which could adversely affect the safeguarding of (1) the inviolability of the national territory, (2) military defence plans, (3) the fulfilment of missions of the armed forces, (4) the internal state security (including in relation to nuclear energy), (5) the continuity of the constitutional and democratic order, (6) the external state security and international relations, (7) the scientific and economic potential of the country or any other fundamental state interest, (8) the safety of Belgian citizens abroad, (9) the functioning of the state decision-making bodies and (10) the protection of sources, ongoing judicial investigations or the private life of third parties.
14 Draft Guidelines, questions 8 and 17.
15 Draft Guidelines, question 23.
16 Article 5, §1 of the Cooperation Agreement.
17 Article 3, §2 of the Cooperation Agreement.
18 ibid.
19 Article 3, §3 of the Cooperation Agreement.
20 Article 5, §2 of the Cooperation Agreement.
21 Article 5, §3 of the Cooperation Agreement.
22 Article 6, §2 of the Cooperation Agreement.
23 Article 17, §1 of the Cooperation Agreement.
24 Article 17, §2 of the Cooperation Agreement.
25 Article 6, §3 of the Cooperation Agreement.
26 Article 7, §1 of the Cooperation Agreement.
27 ibid.
28 Article 7, §3 of the Cooperation Agreement.
29 Article 7, §2 of the Cooperation Agreement.
30 Articles 8–10 of the Cooperation Agreement.
31 Article 13, §1 of the Cooperation Agreement.
32 Article 13, §2 of the Cooperation Agreement.
33 Article 13, §4 of the Cooperation Agreement. During the Phase II screening phase, this timing is reduced to at least 15 days. Article 22, §3 of the Cooperation Agreement. The CCIS can request an extension of its review period twice and by up to three months provided that its request is justified by the complexity of the investigation and that the competent members of the ISC do not reach a consensus to reject the request.
34 Article 14 of the Cooperation Agreement.
35 Article 16 of the Cooperation Agreement.
36 Article 17, §2 of the Cooperation Agreement.
37 Article 17, §3 of the Cooperation Agreement.
38 Article 18, §2 of the Cooperation Agreement.
39 Article 18, §1 of the Cooperation Agreement.
40 Article 19, §1 of the Cooperation Agreement.
41 Article 19, §2 and Article 20, §5 of the Cooperation Agreement.
42 Article 22, §3 of the Cooperation Agreement.
43 Article 20, §1 of the Cooperation Agreement.
44 Article 20, §2 of the Cooperation Agreement.
45 Article 20, §3 of the Cooperation Agreement.
46 Article 20, §4 of the Cooperation Agreement.
47 Article 20, §§3 and 4 of the Cooperation Agreement.
48 Article 21, §1 of the Cooperation Agreement.
49 Article 21, §2 of the Cooperation Agreement.
50 Article 23, §2 of the Cooperation Agreement.
51 ibid.
52 Article 23, §4 of the Cooperation Agreement.
53 Article 23, §6 of the Cooperation Agreement.
54 Article 29, §§1 and 4 of the Cooperation Agreement.
55 Article 29, §2 of the Cooperation Agreement.

56 ibid.
57 Article 29, §3 of the Cooperation Agreement.
58 Article 25 of the Cooperation Agreement.
59 Article 24 of the Cooperation Agreement.
60 Article 26 of the Cooperation Agreement.
61 Article 27 of the Cooperation Agreement.
62 Article 28, §1 of the Cooperation Agreement.
63 Article 28, §2 of the Cooperation Agreement.
64 Article 28, §4 of the Cooperation Agreement.

Chapter 4

Canada

Huy Do, Andrew House and Robin Spillette[1]

Summary

I OVERVIEW

The Investment Canada Act (ICA) (the Act), which was enacted in 1985, governs foreign investment in Canadian businesses.[2] Generally, investments by non-Canadians in Canadian businesses, or the creation of new Canadian businesses by a non-Canadian, require notification or approval under the Act, if the investments meet certain structural or monetary thresholds. The foreign investment review and approval regime under the Act is aimed at balancing the benefit from foreign direct investments, which support the growth and development of Canadian businesses, with the need to ensure that such investments are in fact of benefit to Canada and do not bring with them national security threats. The words 'national security' are not defined in Canadian law – a situation that tends to grant federal authorities wide latitude in determining what constitutes a threat to the essential security interests of the country, and one in which it can be difficult for investors and target businesses alike to determine how the government may react to or manage a given proposed investment. While net benefit reviews remain fairly infrequent under the Act, and generally receive approval (albeit with some commitments being required on the part of the foreign investor), there has been an increase in scrutiny with respect to national security in recent years. In particular, in the wake of the covid-19 pandemic, there has been increased scrutiny with respect to investments in areas of critical infrastructure that are important to the health and safety of Canadians, and in response to the Ukraine crisis, there has been increased caution with respect to investments by Russian investors. Because of increased pressure placed on the Canadian economy by the covid-19 pandemic and the following economic slowdown, there has also been increased caution to ensure that foreign investors are not taking advantage of distressed Canadian businesses that are facing sudden declines in valuations. Although Canada's understanding of its national security has always admitted considerations relating to critical infrastructure, this concept has grown well beyond the traditional emphasis on combating espionage and countering violent extremism to consider the basics of life in Canada: what are the people, processes and institutions that keep Canadians alive, warm, sheltered and fed? Considerations of this kind have not entered into the calculus of public administration for at least two generations but are now at the forefront of what Canadian policymakers must consider when crafting and administering security policy.

II YEAR IN REVIEW

Over the past year, the government of Canada has continued to expand the scope of its authority over investments that could pose threats to Canada's national security. On 7 December 2022, the Minister of Innovation, Science and Industry (the Industry Minister) tabled Bill C-34, National Security Review of Investments Modernizations Act (Bill C-34),[3] which would significantly amend the Act. Bill C-34 aims to bolster protection against security threats that may arise from foreign investment and streamline the existing national security review process.

In addition to Bill C-34, the federal government has enacted several policies that have further stressed its intent to play a greater role in scrutinising economics-based security threats through investment review mechanism – especially in the critical minerals sector. On 28 October 2022, the federal government published the Policy Regarding Foreign Investments from State-Owned Enterprises in Critical Minerals under the Investment Canada Act (the SOE Policy), indicating its intent to more closely scrutinise investments into Canada's critical minerals sector that may be 'motivated by non-commercial imperatives that are contrary to Canada's interests'.[4] Following the announcement of the policy, the Industry Minister ordered the divestiture of three investments by Chinese investors in Canadian critical mineral companies on 2 November 2023. The federal government emphasised that the policy and the divestiture orders are consistent with the Critical Minerals Strategy, which was formally launched on 9 December 2022.[5]

The tabling of Bill C-34 and the critical minerals policy altogether underscore the government's goals of securing Canada's economic and national security interests while keeping Canada an attractive destination for foreign investment and thereby promoting economic growth. In the 2021/2022 fiscal year, 24 investments were notified for extended review, the same number as in the previous year, and, of these, 12 received approval for formal review.[6] By comparison, the average number of notices of potential national security reviews between 2016/2017 and 2020/2021 was 10 and the average number of orders for a national security review was 6.4.[7] From 2009 (when the national security provisions came into effect) until 2016, only a total of eight national security reviews were ordered.[8]

The federal government's legislative and policy moves will likely allow the Industry Minister to more agilely align Canada's foreign investment mechanism with Canada's broader foreign policy and domestic goals to respond to emerging geopolitical challenges in collaboration with like-minded governments. The proposed amendments under Bill C-34, if passed, would impose new filing requirements prior to the implementation of investments in 'prescribed business sectors' and allow the Industry Minister to initiate national security reviews, impose stronger penalties for non-compliance, impose conditions during a national security review and allow more information-sharing with international counterparts while better protecting information relating to national security during the course of judicial reviews.[9] The November 2022 divestiture of the three Chinese investments in the critical minerals sector provides a useful case study that explains the broader trend that is driving these changes in the Act.

III FOREIGN INVESTMENT REGIME

i Policy

As described further below, an investment by a non-Canadian may be subject to a net benefit review or a national security review under the Act. Under a net benefit review, the applicable minister must determine whether a foreign investment is of net benefit to Canada by considering, among other things, the following factors:

- the effect of the investment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment; resource processing; the utilisation of parts, components and services produced in Canada; and exports from Canada;
- the degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada of which the Canadian business or new Canadian business forms, or would form, a part;
- the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- the effect of the investment on competition within any industry or industries in Canada;
- the compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment; and
- the contribution of the investment to Canada's ability to compete in world markets.[10]

With respect to a national security review, the federal Governor in Council (the GIC and, for all intents and purposes, the federal Cabinet (the Cabinet) or a component thereof) will consider whether the investment would be injurious to national security.[11] While 'national security' is not defined in the Act, the National Security Guidelines (the NS Guidelines) do note that the nature of the assets (including intangible assets), business activities and parties involved in the transaction, including the ultimate controller and potential for third-party influence, are considered as part of a national security review. The NS Guidelines also include a list of factors that are considered, such as:

- the potential effects of the investment on Canada's defence capabilities and interests;
- the potential effects of the investment on the transfer of sensitive technology or know-how outside Canada, on the supply of critical goods and services to Canadians, on critical minerals and critical mineral supply chains, or on the security of Canada's critical infrastructure;
- involvement in the research, manufacture or sale of certain goods or technology identified in the Defence Production Act;

- the potential of the investment to enable foreign surveillance or espionage, or to hinder current or future Canadian intelligence or law enforcement operations;
- the potential impact of the investment on Canada's international interests;
- the potential of the investment to involve or facilitate the activities of illicit actors; and
- the potential of the investment to enable access to sensitive personal data that could be leveraged to harm Canadian national security through its exploitation.

Canada has been at pains both to enhance the robustness of its national security approach to respond to an evolving and multi-vectored threat environment and to ensure that its investment control regime does not diminish the attractiveness of Canada as a destination for fluid international capital. This fine balance has been difficult to strike during the pandemic, and the invasion of Ukraine has served to make the situation even more volatile. However, this latter factor has also appeared to galvanise the resolve of western allies to counter threats to western liberal democracy more cooperatively – an outcome that was most likely not envisioned by proponents of the war in Ukraine.

The SOE Policy further underscores this broader trend driven by geopolitics. Building on the Critical Minerals List that was released on 11 March 2021, the Industry Minister unveiled the SOE Policy on 28 October 2022, which established that the applications for acquisitions of control of a Canadian business involving critical minerals by a foreign SOE will be approved only on an exceptional basis due to 'the strategic importance of Critical Minerals and inherent economic risks posed by foreign SOEs or private investors'.[12] Further, the SOE Policy states that the participation of an SOE or 'foreign-influenced private investor' would establish 'reasonable grounds to believe that the investment could be injurious to Canada's national security . . . regardless of value, whether direct or indirect, whether controlling or non-controlling, and across all stages of the value chain'.[13] Following the introduction of the SOE Policy, the federal government ordered the divesture of three investments by Chinese investors in Canadian critical mineral companies on 2 November 2022.[14] The SOE Policy and divestiture of Chinese investments in the critical minerals sector reflect Canada's efforts to collaborate more closely with the group of western democracy allies led by the United States, which attempts to check China's dominance in the sector and ensure competitiveness in high-tech sectors.[15]

ii Laws and regulations

The Act is the statute of general application in Canada with respect to foreign investment (sector-specific federal and provincial statutes are discussed below). Two sets of regulations exist under the Act: the Regulations Respecting Investment in Canada (which prescribe the information required to be submitted when an investment is subject to notification or approval under the Act) and the National Security Review of Investments Regulations (which prescribe, among other things, the timelines for national security reviews under the Act). The Act is administered by the Investment Review Division (IRD) of the federal Department of Innovation, Science and Economic Development, with the exception of investments in cultural businesses, which are administered by the Cultural Sector Investment Review (CSIR) unit within the federal Department of Canadian Heritage. Both the IRD and the CSIR may be involved if an investment involves both non-cultural and cultural businesses. The ultimate decision to approve or disallow an investment is made by the Industry Minister, or the Minister of Canadian Heritage and Official Language (the Cultural Minister) in the case of investments involving cultural businesses. Where an investment involves both non-cultural and cultural businesses, both ministers may be involved. Examples of cultural businesses include those in the areas of publishing, film, video and music. The national security provisions of the Act are administered by the IRD, with the GIC (i.e., the Cabinet) as the ultimate decision-maker.

As discussed above, the Industry Minister introduced Bill C-34 in December 2022. As at July 2023, Bill C-34 is at the second reading stage in the House of Commons. If passed, Bill C-34 would significantly amend the Act to expand its scope and further empower the Industry Minister but, at the same time, streamline the review process.

iii Scope

The Act applies to (1) the establishment of a new Canadian business by a non-Canadian (as defined in the Act), (2) the acquisition of control of an existing Canadian business by a non-Canadian and (3) the acquisition of, in whole or in part, or the establishment of an entity carrying on all or any part of its operations in Canada, if the entity has (1) a place of operations in Canada, (2) an individual or individuals in Canada who are employed or self-employed in connection with the entity's operations, or (3) assets in Canada used in carrying on the entity's operations.[16] Under the Act, non-Canadian investor will generally be required to submit only a post-closing notification;[17] however, if certain monetary thresholds are met, the approval of the investment based on a 'net benefit to Canada' test is required.[18] Additionally, regardless of the value of the transaction, all activities by non-Canadians that are caught by the Act may be subject to a review under the national security provisions of the Act.[19]

The proposed amendments under Bill C-34 would expand the scope of the Act. More specifically, the proposed amendments would create a pre-implementation filing requirement for certain investments, including (1) investments in a Canadian business that carries on a 'prescribed business activity'; (2) investments that grants access to or direct use of 'material non-public technical information' or 'material assets' to a non-Canadian; or (3) investments that grant the power to appoint or nominate a member of the board of directors or senior management, a trustee or a general partner (in case of a limited partnership) or 'prescribed special rights' with respect to the entity.[20] The amendments would allow the federal government to define terms such as 'prescribed business activity', 'material non-public technical information', 'material assets' or 'prescribed special rights', granting it greater flexibility to adjust the scope of the Act as needed.

Establishment of new Canadian business

In most cases, the establishment of a new Canadian business by a non-Canadian is merely notifiable and not subject to approval. However, the establishment of a new Canadian business in the cultural sector may require approval if the GIC determines the review of the investment to be in the public interest.[21] Additionally, a national security review may be initiated in respect of the establishment of a new Canadian business.[22]

Acquisition of control of Canadian business

Direct or indirect acquisitions of control of Canadian businesses (whether or not already foreign controlled) by non-Canadians are, at a minimum, subject to notification under the Act (except for a limited number of exceptions).[23] Where direct acquisitions of control, and certain limited indirect acquisitions of control, by a non-Canadian exceed certain monetary thresholds, the investment will require the approval of the Industry Minister or the Cultural Minister, or both, based on a net benefit to Canada test.[24] The proposed amendments under Bill C-34 would require a new filing requirement prior to the implementation (i.e., closing) of investments in the prescribed business activity by non-Canadians.[25] While 'prescribed business activity' has not been defined, it will likely track with those outlined in the NS Guidelines and include the 'sensitive technology areas' listed in its Annex (e.g., artificial intelligence and biotechnology, etc.).[26] Further, Bill C-34 would also introduce a penalty for non-compliance with this filing requirement for non-Canadian investors, which should not exceed the greater of C$500,000 or any prescribed amount.[27]

National security review

Where the Industry Minister has reasonable grounds to believe that a proposed or implemented investment by a non-Canadian could be injurious to national security, it may be reviewed by the GIC.

The proposed amendments under Bill C-34 would streamline the national security review process by further empowering the Industry Minister. First, the Industry Minister would be able to initiate national security reviews by consulting with the Minister of Public Safety, instead of having to obtain an order from the GIC (i.e., the Cabinet).[28] In addition, the Industry Minister, with the concurrence of the Minister of Public Safety, would have the authority to (1) impose 'interim conditions' during a national security review[29] and (2) accept undertakings to mitigate national security risk.[30]

Finally, the Bill C-34 amendments would allow the Industry Minister to share information with the international counterpart for the purpose of national security reviews of foreign investments[31] but at the same time allow 'closed proceeding on judicial review' that protects information that 'would be injurious to international relations, national defence or national security or would endanger the safety of any person if disclosed'.[32] These amendments would bolster Canada's capacity to cooperate more effectively with its allies at the international level (e.g., the Five Eyes initiative).

iv Voluntary screening

An investor may consider a voluntary notification where they are concerned regarding the potential for a national security review under the Act and are seeking certainty in this regard. As noted above, the Act authorises national security reviews of the following types of investments, whether implemented or proposed, by non-Canadians into Canada where the Industry Minister has reasonable grounds to believe that such an investment could be injurious to Canada's national security:

- the establishment of a new Canadian business or an entity carrying on operations in Canada;
- the acquisition of control of a Canadian business, including a part of a business capable of being carried on as a separate business, of any dollar value; and
- the acquisition of all or part of an entity carrying on operations in Canada.[33]

With respect to an investment that requires either a notification or an application for review under the Act (i.e., those falling into the first two categories above), the Industry Minister has 45 days after the date on which the filing was certified to (1) issue a notice that a national security review may be ordered or (2) order a formal review.[34] Investments that fall into the third category, such as an acquisition of part of a Canadian business that does not constitute an acquisition of control of that Canadian business under the Act, do not require any filing. As such, the Industry Minister has five years after the date of implementation of the investment to decide whether to commence a national security review.[35] This creates significant uncertainty for investors. As such, where an investor is concerned regarding a potential national security review, they may choose to file a voluntary notification. The Industry Minister would then have 45 days from the date on which the voluntary filing is certified as complete to initiate a national security review.[36] In accordance with the guidance provided by the government, investors are strongly encouraged, particularly where they are state-owned or subject to state influence, or in cases where the factors listed in the NS Guidelines may be present, to file a voluntary notification at least 45 days prior to the planned implementation of the investment.[37]

v Procedures

Notifications

If only a notification is required under the Act, the investor may file the notification prior to the implementation of the investment or up to 30 days post-closing.[38] Where the investment involves a cultural business or where national security issues could arise, it may be beneficial to file on an earlier basis, to ensure that any issues are resolved prior to closing.

As discussed above, Bill C-34 would significantly change the Act by adding a new pre-closing filing requirement for prescribed business activity, which would require non-Canadians investing in these prescribed sectors to notify before the closing of the investment.[39]

Net benefit review

Where a transaction is subject to net benefit review under the Act, it cannot close until approval has been received or is deemed to have been received, subject to limited exceptions.[40] Notably, where a delay in implementing the investment would result in 'undue hardship' to the non-Canadian or would jeopardise the operations of the Canadian business that is the subject of the investment, a transaction may be implemented prior to receiving approval.[41] The applicable minister has 45 days after the filing of an application for review to decide whether to approve the investment on the basis that it is likely to be of net benefit to Canada.[42] That being said, the minister may extend the initial 45-day review period by 30 days or such longer period as the investor and the minister may agree.[43] The investment is deemed to be approved if no notice is sent by the minister within the initial 45-day period, or within the further 30-day or longer period if the initial period is extended.[44]

Where the minister declines to approve a transaction because it will not be of net benefit to Canada, the investor has an additional 30 days (or such longer period as the investor and the minister agree) to make further representations to the minister, including the submission of undertakings.[45] The minister must then inform the investor of their decision at the end of this 30-day (or longer) period.[46]

National security review

As described above under Section III.iv, the Industry Minister has 45 days from the filing of a notification, or five years from the implementation of an investment where no filing is required and no voluntary filing is made, to (1) issue a notice that a national security review may be ordered (which triggers an additional period for review of 45 days to consider whether a formal review is needed) or (2) order a formal review (which triggers an additional period for review of 90 days to consider what measures to protect national security will be taken, if any).[47] The national security review process can take up to 230 days from the implementation of the transaction (where a notification or application is filed), or such longer period as the investor and the Industry Minister agree.[48] Notably, the deadlines for the Industry Minister to make a net benefit determination are postponed if a national security review is initiated.[49]

vi Prohibition and mitigation

For the 2021/2022 fiscal year,[50] 1,255 applications were filed, representing an increase of 51.9 per cent from the previous year, when there were 826.[51] Of 1,255 applications, 1,247 were notifications that were certified and eight were of net benefit to Canada reviews that were all approved.[52] The federal government conducted extended reviews (i.e., national security reviews) on 24 investments, of which 16 were permitted to proceed, seven were withdrawn and one is still ongoing.[53] The GIC approved formal reviews of 12 investments, of which 10 involved either Chinese (six) or Russian (four) investors, underscoring that geopolitical factors have been driving the changes to the regulatory framework.

IV SECTOR-SPECIFIC REQUIREMENTS

Prohibited and restricted sectors

Under the Act, there are no sectors in which foreign investment is strictly prohibited or specifically restricted (i.e., subject to a value cap, etc.). However, foreign investments in certain areas are less likely to be approved (or approved without conditions) by either the applicable minister, in respect of a net benefit review, or the GIC, in respect of a national security review. For example, foreign investments in Canadian businesses that meet the definition of a cultural business are unlikely to be approved without the foreign investor making certain undertakings (i.e., commitments to the government) regarding the operation of the Canadian business in the future. Moreover, as discussed above, the SOE Policy establishes that all applications for acquisitions of control of a Canadian business involving critical minerals by a foreign SOE will be approved only on an exceptional basis, and that the participation of an SOE or a foreign-influenced private actor would establish the grounds for conducting a national security review.[54]

As discussed above, Bill C-34 would also prescribe certain business activity from non-Canadian investors and impose a new pre-closing filing requirement,[55] as well as introducing monetary penalties for non-compliance.[56] While 'prescribed business activity' has not been defined, the list of sensitive technology from the NS Guidelines will likely be included in its scope, which include, but are not limited to, advanced materials and manufacturing; advanced ocean technologies; advanced sensing and surveillance; advanced weapons; aerospace; artificial intelligence; biotechnology; energy generation, storage and transmission; medical technology; neurotechnology and human–machine integration; next-generation computing and digital infrastructure; position, navigation and timing; quantum science; robotics and autonomous systems; and space technology.

Aside from the Act, there are additional sector-specific and provincial laws that apply to foreign investment and that may limit it in certain circumstances. For example, some provinces have implemented measures to protect sensitive sectors, including imposing special taxes on the acquisition of residential properties and restricting the ownership of certain lands by foreign investors.[57] In addition, other federal legislation sets specific limits on foreign ownership in certain industry sectors, including, for example, broadcasting, telecommunications and transportation.[58]

V TYPICAL TRANSACTIONAL STRUCTURES

i Establishing a new Canadian business

Foreign companies considering establishing a new Canadian business have various options available to them. The most optimal structure for a new Canadian business will depend on, among other things, the tax structure and liability structure that are most beneficial for the foreign investor. Available business structures include, among other things, corporations, sole proprietorships, partnerships, joint ventures, franchises and cooperatives. Notably, while a Canadian partner is not required, a joint venture between a Canadian company and a foreign investor can be an attractive option, as it combines the strengths of the participating firms while reducing the risk of taking on new markets for a foreign investor. Joint ventures take several forms. They can be set up through a separate corporation or a general or limited partnership, or the parties in a joint venture can jointly own business assets. When considering setting up a Canadian corporation, foreign investors should give consideration to the jurisdiction of incorporation, as the federal and provincial corporate law statutes have different requirements, including different director residency requirements. For example, federally incorporated corporations have a 25 per cent Canadian residency requirement for directors; however, there is no similar residency requirement for directors of a corporation incorporated in British Columbia.[59] Where foreign investors do not want to set up a Canadian subsidiary, they can consider operating in Canada through a branch operation that is an extension of the foreign parent and that requires licensing or registering in any province in which it operates. Foreign investors can also consider, in certain provinces, setting up an unlimited liability company that can act as a 'pass through' to the foreign parent for tax purposes.

ii Acquisition of an existing Canadian business

When considering the acquisition of an existing Canadian business, foreign investors must consider whether the target is publicly listed or privately held, and whether the acquisition will be implemented by way of an asset purchase or a share purchase. There are several factors that must be considered in this regard. Where a Canadian business is publicly listed, a share acquisition would require compliance with, among other things, Canadian securities laws and the applicable securities regulators in each province. Depending on the relationship between the Canadian business and the foreign investor, a share purchase may be hostile or friendly, and may be carried out by way of a takeover bid, amalgamation or plan of arrangement. Key preliminary issues for a foreign investor to consider in a share purchase of a public company include:

- change of control consequences for any material contracts;
- regulatory requirements;
- outstanding options or warrants;
- existing and potential shareholder rights plans;
- existence of any bonds, debentures, convertible securities or rights to acquire securities;
- contingent liabilities;
- coat-tail provisions for non-voting or low-vote shares; and
- location of the target's shareholders.

Notably in Canada, takeover bids cannot be conditional on the purchaser obtaining the necessary financing to complete the bid, as securities laws stipulate that the purchaser must make 'adequate arrangements before the bid to ensure that the required funds are available'.[60] Other forms of acquisitions do not have a similar 'fully funded' rule and can include a financing condition. When completing a share purchase of a private company, foreign investors should keep in mind, among other things, that where a Canadian company is private, it has no obligation to make public disclosure and may often lack the resources to maintain full and accurate internal records and document management systems. As such, a large risk when acquiring the shares of a private company is the reliability of information. Due diligence should be focused on ensuring the accuracy of the information provided by the private target, and a foreign investor will generally want the Canadian business to represent and warrant that its information is accurate and complete. A foreign investor may prefer to proceed by way of an asset transaction if the existing liabilities of a target are a concern. When acquiring assets, certain consents may be required, including the consent of the target's creditors, shareholders and certain third parties. Foreign investors should also be cognisant of certain legislation that may be triggered by an asset purchase but not a share purchase, such as employment legislation. As contracts of employment are not automatically assigned to a purchaser in an asset transaction, application of the various provincial labour relations legislation and employment standards acts must be considered.

VI OTHER STRATEGIC CONSIDERATIONS

There is limited interaction between the merger control regime under the Competition Act[61] and the foreign investment regime. Among other things, the effect of the investment on competition within any industry or industries in Canada is one of the factors explicitly considered under the net benefit assessment under the Act.[62] Where a merger is notifiable under the Competition Act, it is common practice to note this in the application for review submitted under the Act. Any factors that make the investment pro-competitive should also be described in an application for review. Where approval under the Competition Act is provided by the Competition Bureau, this factor would weigh in favour of a finding of net benefit. However, where significant competition impacts are identified by the Competition Bureau, this could be a factor detracting from a finding of net benefit. Because the Act may culminate in a decision by the GIC (which for present purposes has been described as being synonymous with the Cabinet) and, in the Westminster parliamentary tradition, the Cabinet comprises individuals who owe their presence in Cabinet to having first been elected, political considerations inevitably arise in relation to media pressure, constituent backlash, jobs created or lost, and communities supported or seemingly abandoned. It is for this reason that investors must consider the political dimension of a transaction subject to notice or review, taking careful note of the pros and cons of simply permitting a deal to stand on its own merits with officials. In some cases, it will be crucial to prevent the formation of negative narratives before they gain traction in the system that ultimately briefs ministers. In others, it will be necessary to marshal stakeholder support for an investment and to direct that support towards the political class. Built into the Act is a mandatory mechanism for consultation with provinces and territories that may be impacted on by a contemplated transaction. As such, stakeholder work in Canada should extend to the sub-national level. Canada has a federal lobbyist registration regime (which is mirrored to a greater or lesser extent in most provincial jurisdictions) known for its rigour. This regime must be closely adhered to with respect to decisions to communicate with political actors outside the strict mechanism provided under the Act.

VII OUTLOOK

Given the current global economic uncertainty and the recent economic slowdown in Canada, it is likely that Canadian companies will continue to (and, perhaps, increasingly) look to global capital to help support their growth. That being said, it is expected that there will continue to be increased scrutiny of foreign investment to protect struggling Canadian businesses from acquisition by foreign investors at a depressed value. Moreover, as noted above, national security concerns, in particular with respect to Chinese and Russian affiliated investors and critical infrastructure, are expected to mean increased scrutiny of foreign investment (and potentially delayed review timelines) for the foreseeable future. Canada has established an Economic Security Task Force.[63] Whether the mandate of this entity is to study and counter threats to Canada's economic security or monitor and deter economic-based threats to our national security is unclear – perhaps these are deeply interconnected sides of the same coin. The results of a federal consultation may further impact on how national security intersects with foreign investment and the conduct of national security reviews under the Act. The government is undoubtedly trying to develop a more coherent and sustainable mechanism for reviewing foreign investment that allows it to balance its goals of securing national security interests and collaborating more effectively with Canada's allies while keeping it an attractive destination for foreign investment. The passage of Bill C-34 and its judicious implementation (considering the expanded scope of the Industry Minister's authority) will determine whether Canada will be able to have it all.

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Chapter 5

China

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Summary

I OVERVIEW

There are two separate regimes regulating foreign investment in China: the foreign investment regime and the national security review regime. The former regime is applicable to all foreign investment activities carried out directly or indirectly by foreign investors in China, while the latter regime applies only to foreign investment that raises national security concerns.

Foreign investment in China is classified into four categories: encouraged, permitted, restricted and prohibited. The Chinese government uses a system of Negative Lists (as defined below) to control foreign investment in prohibited sectors, which is not allowed, while foreign investment in restricted sectors is permitted, subject to certain restrictions (such as foreign ownership limits). Foreign investors are incentivised to make investment in the encouraged sectors listed in the Catalogue of Encouraged Industries for Foreign Investment (the Encouraged Industries Catalogue). The Negative Lists and the Encouraged Industries Catalogue are usually updated every one to two years by the Ministry of Commerce (MOFCOM) and the National Development and Reform Commission (NDRC). Foreign investment in sectors that are not listed in the Negative Lists or the Encouraged Industries Catalogue is deemed permitted.

The main government authorities with responsibility for foreign investment review include MOFCOM, NDRC and the State Administration for Market Regulation (SAMR), which is China's corporate registry. Previously, any foreign investment that fell within the restricted sectors needed to be approved by MOFCOM before registration with SAMR or its local branches. Since the Foreign Investment Law (FIL) came into effect on 1 January 2020, prior approval of MOFCOM is no longer required in any case. Instead, as part of the corporate registration process, SAMR or its local branches will review the information provided by foreign investors or foreign invested enterprises (FIEs), or both, to verify whether the underlying foreign investment is in compliance with the restrictions set out in the Negative Lists. In addition, foreign investment that involves fixed asset projects may require the approval of NDRC or its local branches in certain circumstances.

A national security review may also be required if a foreign investment falls within certain categories (see Section III.iii, below). China's national security review regime was introduced in 2011 by the Circular of the General Office of State Council on the Establishment of Security Review for the Merger and Acquisition of Domestic Enterprises by Foreign Investors (the 2011 Circular). The 2011 Circular set forth a national security review regime whereby MOFCOM would take the lead with reviews in coordination with other government agencies. In 2015, the State Council issued the Circular on Issuing Provisional Measures for National Security Review of Foreign Investment in Pilot Free Trade Zones (the Free Trade Zone Circular), under which a slightly modified security review regime was created for foreign investment in the Shanghai, Guangdong, Tianjin and Fujian pilot free trade zones (FTZs). Since 2011, the 2011 Circular and the Free Trade Zone Circular have been applied rarely in practice.

On 19 December 2020, the Measures on National Security Review of Foreign Investment (the NSR Measures) were issued jointly by NDRC and MOFCOM. The NSR Measures amend the 2011 Circular and the Free Trade Zone Circular and provide more detailed rules to implement the national security review regime. According to the NSR Measures, which took effect on 18 January 2021, national security reviews are conducted by a working mechanism (the Working Mechanism) led by NDRC and MOFCOM at an office located at the NDRC. In practice, the national security regime is opaque in terms of timing, procedures and outcome.

The foreign investment and the national security regimes are stand-alone regimes and not part of the merger control regime.

II YEAR IN REVIEW

The most notable development for the foreign investment regime during the past year is that MOFCOM and NDRC jointly published the 2022 version of the Encouraged Industries Catalogue, which became effective on 1 January 2023. The 2022 Encouraged Industries Catalogue comprises two sub-catalogues – one covers the entire country and one covers the central, western and northeastern regions. Compared with the previous 2020 version, the national sub-catalogue has added or expanded items with an aim to attract foreign investment into advanced manufacturing industries and modern service industries. In particular, the newly introduced items cover areas of renewable energy technologies and products, medical consumables, recycling and energy saving technologies, products and related services. In the meantime, to optimise the regional distribution of foreign investment, the central, western and northeastern regional sub-catalogue expands the scope of encouraged industries by reference to the advantages or unique local resources of each province in the regions. Major benefits of investing in an encouraged industry include tariff exemptions on imported self-use equipment within the value of total investment amount, priority access to and preferential price for industrial land supply and, in certain regions, a reduced corporate income tax rate.

As China continues to encourage foreign investment in a wide range of industries, the national security regime has begun to play a more prominent role. China established its national security regime in 2011 but rarely enforced it until 2020, when NDRC replaced MOFCOM as lead coordinator for national security reviews. During the past year, NDRC has called in a number of transactions for national security review, often triggered by third-party complaints, and these reviews have sometimes led to companies abandoning a transaction.

III FOREIGN INVESTMENT REGIME

i Policy

The FIL contains a number of market-liberalising principles (e.g., national treatment of foreign investment) that reflect the Chinese government's desire to facilitate further market access and create a level playing field for foreign investors. Under the FIL, foreign investment is provided with greater protection, such as enhanced protection for a foreign investor's intellectual property rights and trade secrets, and a more simplified and transparent regulatory regime. The Chinese government's continuous revisions to the classification system of foreign investment also shows its efforts to further open the domestic market: the latest Encouraged Industries Catalogue identifies more industries in which China welcomes foreign investment with preferential treatments (see Section II for details), while the Negative Lists have been revised over the years to gradually lift access restrictions on foreign investment.

In the meantime, the introduction of the NSR Measures indicates China's willingness to use its power to review and control foreign investment under the national security review regime to balance the FIL's more liberalised approach to foreign investment.

The NSR Measures are silent on the applicable standard of review, but the 2011 Circular (which has not yet been repealed) provides a review standard at a high level. This includes, for example, whether the underlying transaction will affect national defence and security, the national economy, social order, or research and development capabilities for core technologies relevant to national security. It is anticipated that the NSR Measures may apply similar standards.

ii Laws and regulations

The FIL and its implementing regulations are the fundamental laws and regulations of the foreign investment regime. They establish the principles that foreign investment in certain strategic or sensitive sectors is prohibited or restricted in accordance with the Negative Lists, but national treatment is granted to other foreign investment.

In addition, foreign investment may also need to comply with applicable sector-specific regulations issued by relevant sector regulators. For example, the China Banking and Insurance Regulatory Commission – the former primary regulator for the banking and insurance sectors (which was replaced by the National Administration of Financial Regulation in May 2023) – has issued regulations in relation to foreign investment in those sectors.

Depending on transaction structure and other factors, there are additional regulations and rules with which the foreign investment may need to comply. For example, if the target company is listed on a Chinese stock exchange, the Chinese securities law and relevant stock exchange rules shall apply. If the target company is a state-owned company, regulations that govern the acquisition of state-owned assets will come into play.

The main regulation that governs the national security review is the NSR Measures, which generally combine the features of the previous regulations (the 2011 Circular and the Free Trade Zone Circular) and provide further detailed rules on how the national security framework will be operated. However, the 2011 Circular and the Free Trade Zone Circular have not yet been repealed and, technically, remain effective.

iii Scope

Under the FIL, foreign investment means any direct or indirect investment activity conducted by foreign investors (including foreign individuals, enterprises or other organisations) within China, including but not limited to incorporation of FIEs, acquisition of equity interests or assets in Chinese companies and investment in greenfield construction projects.

Foreign investors and FIEs that carry out investment activities within China must observe Chinese laws and regulations. In practice, foreign investment falling within the Negative Lists will be reviewed by SAMR or its local branches in the corporate registration process or relevant sector regulators, or both, in the operating licence approval process. Offshore merger and acquisition (M&A) transactions that take place outside China (e.g., offshore acquisition of an FIE's foreign shareholder) are not subject to the Chinese foreign investment review regime; however, if an offshore transaction results in changes to the information in the reports submitted to MOFCOM or its local branches (e.g., a change of the actual controller of the foreign investor), these changes should be reported to MOFCOM or its local branches.

Foreign investment that involves fixed asset construction (including modification and expansion) may also require NDRC's approval or filing procedure.

For national security reviews, a filing obligation will be triggered in either of the following situations:

- investments in military or military-related industries or investments located near military facilities; or
- acquisition of control over a Chinese target active in critical agriculture, critical energy and resources, significant equipment manufacturing, critical infrastructure, critical transportation services, critical cultural products and services, critical products and services relating to information technology or the internet, critical financial services, key technologies and other critical sectors. This 'control' covers situations in which a foreign investor:
  - holds 50 per cent or more of the target's shares post-transaction;
  - holds fewer than 50 per cent of the target's shares but has sufficient voting rights to materially influence resolutions at meetings of shareholders or the board of directors; or
  - can exercise material influence over key matters such as business decisions, personnel, finances and technology through other means.

What is considered as 'critical' is not set out in any regulation, leaving the Working Mechanism with discretion to make determinations that shift from time to time with changes in policies or national security outlook. Furthermore, the NSR Measures include a catch-all clause, which allows the authority to further expand the scope of transactions subject to the national security regime. Owing to the absence of detailed rules and insufficient precedents, an analysis is required in each case to determine whether a transaction triggers filing obligations.

In terms of the covered transaction types, the national security regime covers both direct and indirect investments in the form of M&A, greenfield investments (both wholly owned projects and joint ventures) and investments through other means (potentially capturing an acquisition through contractual means such as a variable interest entity (VIE) arrangement). Under the NSR Measures, an indirect acquisition of a domestic enterprise already owned by foreign investors (e.g., as a result of a pure offshore transaction) can also be subject to the national security review regime.

An investor is deemed a foreign investor if the investor is not Chinese or is not incorporated in China. For the purposes of the foreign investment review and national security review regimes, Hong Kong, Macau and Taiwan investors are considered foreign investors.

iv Voluntary screening

Both the foreign investment review and the national security review regimes are mandatory.

As mentioned above, reporting of foreign investment information to MOFCOM is mandatory. With respect to restricted investments, only those that have passed the review of SAMR or its local branches will be allowed. If a foreign investor invests in a prohibited sector or if a restricted foreign investment does not comply with relevant restrictions, depending on the status of the investment transaction, the foreign investor may be ordered by the authorities to discontinue the transaction, dispose of the shares or assets (or both) acquired or unwind the transaction.

Regarding the national security review regime, the NSR Measures make clear that the regime is mandatory and an investment caught by the regime must be filed for national security review. Although there is no monetary penalty for failure to notify, the office of the Working Mechanism has the power to require the concerned parties to submit a filing.

v Procedures

The following are the major steps of the review and reporting procedures in connection with foreign investment:

- Foreign investment review procedures: China implements a 'national treatment plus negative list' approach for foreign investment in China. SAMR and its local branches will review the documents submitted by a foreign investor or an FIE, or both, during the corporate registration process. If the relevant foreign investment falls within a restricted sector under the Negative Lists, the foreign investor or the FIE will also need to inform SAMR (and, if applicable, the relevant sector regulator) that applicable requirements under the Negative Lists have been complied with. After its review, SAMR will register permitted or encouraged investments as well as restricted investments that comply with the relevant restrictions and requirements, but it will reject the registration of prohibited investments.
- Foreign investment information reporting system: pursuant to the Measures for the Reporting of Foreign Investment Information (the Reporting Measures), where foreign investors carry out investment activities directly or indirectly within China, the foreign investors or the FIEs must report investment information to MOFCOM or its local branches by submitting certain required reports through the online enterprise registration system and the National Enterprise Credit Information Publicity System. Depending on the type of foreign investment, foreign investors or FIEs may need to submit (1) initial reports (when a foreign investor establishes an FIE through a greenfield investment or acquires a stake in a non-FIE company via an M&A transaction), (2) change reports (when any information in the initial reports needs to be updated) and (3) annual reports. In terms of the change report, usually, an FIE should file such report simultaneously when it applies for the registration or record-filing of change to the FIE through the online enterprise registration system or, where procedures on registration or record-filing of change to the FIE are not involved, within 20 days of the occurrence of the relevant change. Although MOFCOM may update the form of the reports periodically, the required information usually includes corporate information about the

invested enterprise, information about the investors and their actual controllers; details of the invested enterprise's business operation, assets and liabilities; and details of any applicable industry licences and permits.
- Project approval or record-filing by NDRC: depending on the sector and scale, foreign investment that involves fixed asset projects may require the approval of, or record-filing with, NDRC or its local branches prior to the commencement of the investment project. If the approval process is triggered, the authority will have up to 30 business days to verify whether the underlying project is consistent with the foreign investment regulations, relevant industrial policies and public interests.

For national security reviews, the foreign investor is allowed to request a prior consultation from the office of the Working Mechanism before making a formal notification. The consultation timeline is subject to the authority's sole discretion, which may generally vary between one and three months.

The national security review consists of three phases:

- a preliminary review to determine whether a foreign investment falls under the national security review regime must be completed within 15 business days;
- a general review must be completed within 30 business days if a foreign investment is subject to the national security review regime and raises no issues; and
- a special review must be completed within 60 business days but can be extended in special circumstances if a foreign investment affects or may affect national security. These 'special circumstances' are not defined and there are no statutory time limits for extending the review period.

The NSR Measures introduced a 'stop-the-clock' mechanism. This enables the authority to pause the review period while it awaits a foreign investor's responses to information requests. Foreign investors will need to address the authority's requests promptly to advance the review process.

Although the investment in question can be referred to the State Council for determination under the prior rules, such a referral no longer exists under the NSR Measures. This means the decision by the Working Mechanism is final and cannot be appealed.

vi Prohibition and mitigation

In terms of the national security review regime, the Working Mechanism may prohibit or impose remedies on a transaction. Although it remains unclear what types of remedies will be acceptable in a given case, both structural and behavioural conditions may be explored if a foreign investment in China attracts national security concerns. For example, NDRC reportedly called in Diodes Incorporated's acquisition of Lite-On Semiconductor for a national security review. According to public sources, the Taiwan-based target eventually sold its controlling stake in a Chinese subsidiary before the parties received both merger control and national security review approval. It is unclear whether the divesture was requested by the Chinese authorities or proposed by the parties proactively to facilitate the review process.

The national security review regime is opaque in terms of review and outcome. There is no publicly available information about the number of transactions that have been reviewed, prohibited or subject to mitigation.

IV SECTOR-SPECIFIC REQUIREMENTS

There are currently three sets of Negative Lists: Special Administrative Measures (Negative List) for the Access of Foreign Investment (the National Negative List); Special Administrative Measures (Negative List) for the Access of Foreign Investment in Pilot Free Trade Zones (the FTZ Negative List); and Special Administrative Measures (Negative List) for Foreign Investment Access in Hainan Free Trade Port (the Hainan Negative List) (together, the Negative Lists). The Negative Lists were last updated in late 2021. The Negative Lists are the primary sources prescribing prohibited and restricted sectors for foreign investment and restrictions that apply nationwide, in all FTZs and in Hainan free trade port (the Hainan FTP), respectively.

Overall, the number of prohibited or restricted sectors has been reduced and the restrictions have been relaxed over the years. In addition, the FTZ Negative List and the Hainan Negative List, as local pilot measures, are less restrictive than the National Negative List, signalling China's intention of further reform in pilot FTZs and the opening up of its market.

i Prohibited sectors

Under the 2021 National Negative List (the latest version), foreign investors are prohibited from investing in 21 industries within 10 areas, ranging from agriculture to information technology and scientific research. The most widely discussed prohibited industries include:

- internet news information services, internet publishing services, and internet video and audio programme services;
- development and application of diagnosis and treatment technologies relating to human stem cells and genes;
- domestic express mail services;
- editing, publishing and production of books, newspapers, periodicals, audiovisual recordings and electronic publications;
- compulsory education;
- social survey service; and
- artistic performance groups.

The FTZ and the Hainan Negative Lists have fewer prohibited areas. For example, foreign investors are not prohibited from making investments in artistic performance groups in FTZs or the Hainan FTP.

ii Restricted sectors

There are currently 10 restricted industries under the 2021 National Negative List. When making investment in a restricted sector, foreign investors should usually team up with Chinese partners and follow certain requirements imposed by the Negative Lists (such as requirements on shareholding percentage and nationality of legal representative). For example, in a Chinese public air transportation company, no single foreign investor is allowed to hold more than 25 per cent equity interest, the company must be controlled by a Chinese shareholder and the legal representative must be a Chinese national. Similar to the case with prohibited sectors, the FTZ and the Hainan Negative Lists have fewer restrictions on restricted sectors than the National Negative List.

As noted above, the national security regime is also a sector-specific regime (see Section III.iii, above). However, there is no publicly available exhaustive list for these sectors or key industries.

V TYPICAL TRANSACTIONAL STRUCTURES

Under the current regulatory regime, there are two principal channels for foreign investors to enter the Chinese market: establishing new FIEs or making investment in existing domestic companies via M&A transactions.

i Establishment of new FIEs

There are generally four types of legal entities available for foreign investment:

- a representative office, which is an agency office of a foreign investor in China for liaison and communication purposes. A representative office is not allowed to conduct business in China and therefore does not serve the business purposes of foreign investors in many cases;
- a wholly foreign-owned enterprise (WFOE), which is a 100 per cent owned subsidiary of a foreign investor;
- a joint venture with a Chinese partner, which is normally used when there is a good commercial reason or where foreign investment restrictions impose a local ownership requirement; and
- a foreign invested joint-stock company, which is normally adopted where there are numerous shareholders, an initial public offering is contemplated or the company is already publicly listed.

ii Investment in existing domestic companies

Investment in private Chinese companies

An M&A transaction by a foreign investor can be structured as a share deal or an asset deal. Under Chinese law, a share deal may be structured either onshore or offshore; however, for an asset deal, the deal would have to be structured onshore because, in most cases, the law requires that an onshore FIE shall be set up to host the assets acquired.

Compared with an onshore structure, offshore acquisitions usually enjoy more flexibility because (1) laws of offshore jurisdictions such as the British Virgin Islands and the Cayman Islands are often more flexible than Chinese law and (2) the Chinese foreign exchange control regime does not apply to offshore transactions in general and thus there are fewer hurdles in deal structure. Nevertheless, foreign investors may still consider establishing an onshore WFOE (directly or through a special purpose vehicle) as its long-term investment vehicle in China.

The purchase price may be paid in cash or in kind (such as intellectual property rights). It is also possible for a foreign investor to use the equity interests in an offshore company to pay the purchase price by way of conducting a cross-border share swap deal. However, the current law severely restricts the permitted scope of cross-border share swaps, which makes implementation of this deal structure very difficult in practice.[2]

Investment in listed companies in China

Foreign investment in companies listed on Chinese stock exchanges (A-share listed companies) is subject to additional requirements under the Chinese securities law and the rules of the relevant stock exchange.

Foreign investors need to satisfy certain qualification requirements (such as the minimum value of assets owned or managed by the foreign investor) before they can invest in A-share listed companies. Under the current regulatory regime, there are three main transaction structures through which a qualified foreign investor can invest in an A-share listed company:

- private placement, which usually involves a listed company issuing new shares to a small group of selected investors, allowing the issuing company to negotiate deals directly with the selected investors and set a share price that is often below market price;
- share transfer by agreement, which involves an acquisition of shares from existing shareholders of the listed company by way of a private share transfer agreement; and
- tender offer, which refers to the investor making an offer to acquire all (a general offer) or some (a partial offer) of the shares held by the other shareholders of a listed company – usually when the investor intends to acquire control.

If a foreign investor holds less than 30 per cent of the shares in an A-share listed company and proposes to acquire shares that will result in the investor holding more than 30 per cent of the shares, unless an exemption is available or granted by the China Securities Regulatory Commission (CSRC), the investor must acquire the additional shares (in excess of the 30 per cent threshold) by making a tender offer. Confirmation from the relevant stock exchange is required on a formal review basis for a private share transfer by agreement, whereas CSRC's approval is required for a private placement.

VI OTHER STRATEGIC CONSIDERATIONS

Apart from the foregoing, it is advisable for foreign investors to consider the following issues when making an investment in China.

i Governing law

Theoretically, nothing under Chinese law prohibits the parties from choosing the law of another jurisdiction as the governing law of a cross-border transaction. In practice, however, Chinese law is the governing law for most onshore investment transactions. For China-related offshore investments, Hong Kong law is a more popular choice.

ii Foreign exchange

Despite the relaxation of China's foreign exchange control regime in recent years, the inflow of investment funds, the repatriation of dividends and the outflow of proceeds from divestment by foreign investors are still subject to various foreign exchange control requirements and must follow prescribed procedures.

iii VIE structure

A VIE structure enables a foreign investor to invest in restricted sectors through contractual arrangements – the foreign investor controls Chinese domestic operating companies holding the required licences through a set of legal agreements rather than through share ownership. It is widely used in the technology, education and healthcare sectors where foreign investments are prohibited or restricted. There are concerns about the enforceability and legitimacy of the VIE structure, as foreign investors effectively circumvent foreign investment restrictions with such a structure. However, the current legal regime remains silent on the legitimacy of the VIE structure, and the Chinese government seems to allow its existence tacitly in practice.

iv Structure of the investment vehicle

Foreign investors can use offshore entities or FIEs to make investments in China. Alternatively, foreign investors may consider using an innovative fund structure – a qualified foreign limited partnership (QFLP) – as a special purpose vehicle to make investments in China. The QFLP allows foreign funds to partner with domestic investors to form a yuan fund within China in the form of a limited partnership, which enjoys more flexibility in foreign exchange settlement and preferential tax treatments. Currently, QFLPs can be formed only in provinces or cities where local QFLP regulations have been promulgated.

v Data protection

China's data protection regime has evolved significantly over the past few years, especially after the promulgation of the Personal Information Protection Law (the PIPL), which is China's first comprehensive data protection law and which came into effect on 1 November 2021. In addition to the PIPL, the Cybersecurity Law (with effect from 1 June 2017) and the Data Security Law (with effect from 1 September 2021) also address data processing activities and protection requirements. The new data protection regime establishes a relatively solid, complete and systematic legal framework to protect personal information in China and, in particular, strengthens controls over data transfers from China to other jurisdictions (commonly referred to as data exports or cross-border data transfers).

The new data protection regime provides three mechanisms that allow organisations to legally export personal data overseas from China:

- to pass a government-led security assessment, which is mandatory if certain conditions are triggered (e.g., the entity transferring data is a critical information infrastructure operator or the data being transferred is classified as important data);
- to conclude a standard cross-border data transfer agreement with overseas recipients, which is optional. It is worth noting that the final form of the long-awaited template was issued on 24 February 2023 by the Cyberspace Administration of China, which is the primary internet regulator in China; and
- to obtain a personal information protection certification issued by a qualified certification institution, which is optional.

China's increasingly tight regulation on data protection could have a significant effect on the daily business operation and data processing activities of FIEs and foreign investors.

vi Overseas listings

Pursuant to the 2021 National Negative List and the official explanation by MOFCOM and NDRC, if a domestic company operates in any sector that is prohibited from foreign investment under the National Negative List and intends to issue shares overseas and have those shares listed and traded, it must first undergo a review and approval process by CSRC, which will solicit opinions from competent sector regulators.

In addition, no foreign investor can participate in the operation and management of the company, and the shareholding percentage held by the foreign investor must comply with the relevant regulations on foreign investment in domestic securities, such as those applicable to qualified foreign institutional investors or the Shanghai/Shenzhen–Hong Kong Stock Connect programmes. This means that foreign shareholders (together with their affiliates) in aggregate are not permitted to own more than 30 per cent of such a company's total shares (across all domestic and overseas markets), and no single foreign shareholder (together with its affiliates) can hold more than 10 per cent of the shares. That being said, companies listed overseas before the issuance of the 2021 National Negative List that exceed the shareholding cap are not required to reduce the percentage of foreign ownership to meet this requirement.

vii National security review

The introduction of the NSR Measures indicates that any future foreign investments that may affect national security will be subject to greater scrutiny by the Chinese authorities. This echoes the global movement towards the adoption of more stringent national security review regimes. It remains to be seen whether the expanded national security review will prove as onerous as in other jurisdictions where national security rules have recently been introduced or tightened. For now, the effect of the expanded national security review regime is modest for the vast majority of foreign investments in China.

For companies whose activities fall within covered sectors, a national security review will no doubt add complexity to proposed investments in China, potentially affecting deal timelines and conditions to be imposed, thereby giving rise to deal uncertainty. Sectors that have attracted investment recently, such as technology, internet and financial services, may be captured by the NSR Measures. Given the uncertainties that have yet to be clarified under the national security review authority's wide discretion, investors are well advised to conduct a thorough national security assessment for transactions and to ensure compliance with national security filing obligations.

VII OUTLOOK

China is pursuing two policies that appear contradictory: on the one hand, continuously opening up its domestic industries to overseas investors while, on the other hand, increasing its screening of foreign investment on national security grounds.

Enactment of the FIL was a milestone. It was designed to reshape China's foreign investment regime with a view towards deregulation. The past year has witnessed the lengthening of the Encouraged Industries Catalogue, which followed the Chinese government's earlier reduction of prohibitions and restrictions set out in the Negative Lists in late 2021. There are also various local pilot programmes to promote foreign investment. These efforts altogether demonstrate China's firm standing on economic opening up and the fact that more and more investment fields now welcome foreign investors. Overall, we can expect that the Chinese government will continue its opening-up policy and optimise the foreign investment environment.

With respect to the national security regime, this has been in place for some time, but the government has only recently started to launch more investigations. However, for the time being, it is not expected to be enforced as actively as China's merger control rules. The 14th Five-Year Plan (2021–2025) indicates that the Chinese government is pursuing high-quality development rather than high-speed growth and 'high-end, intelligent and green production'. Foreign investments in these areas will continue to be welcomed, and China's national security rules are more likely to be applied as a defensive measure instead of too intrusively to deter overseas capital.

That being said, the general expectation is that national security reviews will be a more prominent part of China's foreign investment regulatory framework, given the removal of the pre-vetting procedure for investments in most sectors under the Negative Lists and the shift of the Chinese merger control regime towards focusing on genuine competition issues when reviewing transactions rather than on national security or industrial policy concerns. Furthermore, the rising tide of regulatory scrutiny by Western governments of inbound investments (particularly those from China) are likely to encourage the Chinese government to adopt a retaliatory approach in this respect.

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Endnotes

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2 Note: pursuant to the Provisions of the People's Republic of China on the Merger and Acquisition of Domestic Enterprises by Foreign Investors, only (1) shares of an offshore listed company and (2) in rare cases, shares of an offshore special purpose vehicle established for the purpose of overseas listing of a Chinese 'red-chip' company can be used as consideration for the acquisition of a Chinese domestic company.

Chapter 6

Dominican Republic

Fabio Guzmán Saladín and Pamela Benzán Arbaje[1]

Summary

I OVERVIEW

Foreign direct investment (FDI) plays a crucial role for the economy of the Dominican Republic, as evidenced by the fact that the country is one of the main recipients of FDI in the Caribbean and Central America.

Over the past three decades, the Dominican Republic has fostered a highly receptive environment for international investors, adopting policies that minimise red tape and offering significant tax incentives. For this reason, the country has become the main recipient of FDI in the region, having attracted around US$4 billion in 2022. Historically, tourism, real estate, free trade zones, mining, telecommunications and financing sectors have been the largest FDI recipients.

In January 2020, the government announced a special incentive plan to promote high-quality investment in tourism and infrastructure in the southwest region and, in February 2020, it adopted a public-private partnership law to foster private sector-led economic growth.

The economic growth of the country is remarkable and the international indicators of the Dominican Republic's competitiveness and transparency have held steady despite the negative macroeconomic impacts of the pandemic.

In addition to tax and financial incentives, the country's membership of the Central America Free Trade Agreement-Dominican Republic (CAFTA-DR) is one of the main advantages for foreign investors. This agreement has led to increased competition, strengthening of the rule of law and expansion of access to quality products in the Dominican Republic. The United States remains the single largest investor in the Dominican Republic. CAFTA-DR includes protections for Member State foreign investors, including mechanisms for dispute resolution.

II YEAR IN REVIEW

In 2022, FDI in the Dominican Republic grew substantially by attracting around US$4 billion, according to the United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2023.

The tourism sector played a significant role in the growth of FDI flows in the country, remaining as the leading sector with an investment exceeding US$1 billion for the first time in history, representing 25 per cent of the total FDI flows during 2022.

Regarding the origin of FDI, the United States remains the main investing partner, followed by Spain and Canada. Furthermore, the country received 35 per cent of the investment flows in the Central American region for this year.

It is worth noting that the energy sector experienced the largest absolute growth, with an additional US$475.2 million and a total of US$753.4 million captured. In terms of importance, it is followed by the growth of the trade and industry sector, with an absolute growth of US$292.1 million and a total value received of US$599.5 million.

Furthermore, investments from Brazil totalled US$109.5 million in 2022, representing a significant recovery with an absolute growth of US$303 million. Additionally, US residents made FDI of US$1,520.9 million in the Dominican economy in 2022.

This trend has continued this year, as in the first quarter of 2023, the Dominican Republic reached US$1.0697 billion in foreign investment, considered the highest FDI inflow in history, according to the UNCTAD.

These investments have been focused on the energy sector, which attracted US$272.5 million, representing an 82 per cent growth compared with the first quarter of the previous year. The tourism sector also stands out, attracting around US$271.9 million and registering a 14 per cent increase.

III FOREIGN INVESTMENT REGIME

i Policy

The Dominican Constitution grants foreign and local investors equal treatment under the law, stating expressly that foreigners in the Dominican Republic are entitled to the same rights as Dominican nationals, except in relation to participation in local political activities. Correlatively, foreign investors are bound by the same rules and regulations as those applicable to local investors.

Foreign investors can freely hold equity in local businesses and joint ventures and can purchase real estate in their names.

Shareholders, partners, members, officers and directors of a Dominican company do not need to be Dominican citizens or residents, except in very special circumstances.

To promote exports and facilitate and expedite FDI in the country, the government created the Export and Investment Centre (ProDominicana) of the Dominican Republic. The Centre assists foreign investors in their business activities in the Dominican Republic by providing free advice and information, as well as coordinating regulatory requirements with various government entities. The Centre also sponsors events to promote the Dominican Republic as an investment destination and to provide information to potential investors on how to plan and implement successful business projects in the country.

The Dominican government also assists investors by pledging its full support and credit for loans provided by international agencies for significant infrastructure projects in the Dominican Republic. Foreign investors in large Dominican projects commonly use capital and political or exchange insurance risk facilities provided by the Multilateral Investment Guarantee Agency and the Overseas Private Investment Corporation. The Dominican Republic has signed agreements with both entities.

ii Laws and regulations

Law No. 16-95 on Foreign Investment, enacted on 20 November 1995, and its implementing regulations eliminated all barriers formerly imposed on international investments in the Dominican Republic. Investors contributing capital to companies operating in the Dominican Republic are granted unlimited access to all sectors of the economy, except those relating to national security and certain sensitive industries.

Registration of foreign investments with government authorities is not mandatory, nor is state approval required for the repatriation abroad in foreign currency of capital invested or benefits received by investors.

In a deliberate effort to attract investment capital, the Dominican Republic has set up one of the most wide-ranging systems of incentives for investors. The most important initiatives in this regard are described below.

Incentives to investors in free zones

Under Law No. 8-90 on the Promotion of Free Zones, companies operating in free zones function in a nearly free trade environment and benefit from significant tax exemptions for renewable 15-year periods, such as no income, goods and services, municipal or export taxes, and no import duties nor related charges on raw materials, equipment, construction materials, vehicles, office equipment and other goods necessary for the preparation, construction and operation of the business.

All trade in goods or services to and from a free zone is considered an import or an export, even when the source or destination is another location in the Dominican Republic. As a result, goods and services from the free zones sold in the Dominican market are subject to applicable taxes, such as customs duties and goods and services taxes, except (1) textiles, leather goods and shoes, which benefit from a special programme set up under a special statute;[2] and (2) trade between different free zones that is approved beforehand by the authorities. Furthermore, companies in the free zones exporting goods or services to the Dominican market pay a preferential income tax rate of 3.5 per cent on gross sales.

Free zones are regulated and supervised by the Free Zones National Council, which issues permits allowing companies to operate within a particular free zone and enforces all applicable legislation.

Special incentives for border region free zones

Under Law No. 28-01 Creating a Special Border Development Zone, in addition to the exemptions listed before, companies established and operating in free zones within the border region with Haiti are entitled to further benefits such as an extension of the exemption period from 15 to 20 years, government subsidies to lease space in the free zone and preferential loans with lower interest rates.

Special incentives for logistics operators

Decree No. 262-15 defines logistics operators as companies authorised by the General Directorate of Customs to supply, within a logistics centre, services such as storage, inventory administration, classification, consolidation, cargo distribution, packaging, labelling, division of cargo, refrigeration, re-export and transport.

Logistics operators benefit from a significant reduction in their income tax (which is set at just 3.5 per cent of sales made in the local market) and from import duties on merchandise brought into the country, repackaged and then exported, if this is carried out within a specified period.

Incentives for investors in the tourism industry

The inflow of tourists to the Dominican Republic began with the enactment in 1971 of a special statute granting incentives to investors willing to risk their capital in what was then the least visited tourist destination in the region. Although the country is now the undisputed tourism leader in the Caribbean, companies still benefit from very attractive enticements to invest in the industry. Law No. 158-01 on Tourism Incentives, as amended by Law No. 195-13, and its regulations grant wide-ranging tax exemptions, for 15 years, to qualifying new or refurbished projects undertaken by local or international investors.

The following projects and businesses qualify for these incentives: (1) hotels and resorts; (2) facilities for conventions, fairs, festivals, shows and concerts; (3) amusement parks, ecological parks and theme parks; (4) aquariums, restaurants, golf courses and sports facilities; (5) port infrastructure for tourism, such as recreational ports and seaports; (6) utility infrastructure for the tourism industry, such as aqueducts, treatment plants, environmental cleaning, and garbage and solid waste removal; (7) businesses engaged in the promotion of cruises with local ports of call; and (8) small and medium-sized tourism-related businesses such as shops or facilities for handicrafts, ornamental plants, tropical fish and endemic reptiles.

As regards existing projects, hotels and resort-related investments that are five years old or older are granted 100 per cent exemptions from taxes and duties relating to the acquisition of the equipment, materials and furnishings needed to renovate their premises. In addition, hotels and resort-related investments that are 15 years old or older will receive the same benefits as those granted to new projects if the renovation or reconstruction involves 50 per cent or more of the premises.

Finally, individuals and companies obtain an income tax deduction for investing up to 20 per cent of their annual profits in an approved tourist project.

The Tourism Development Council (Confotur) is the government agency in charge of reviewing and approving applications by investors for these exemptions and, generally, supervising and enforcing all applicable regulations. Once Confotur approves an application, the investor benefiting from the incentives must start and continue work in the authorised project within a three-year period to avoid losing all benefits under the programme.

Because of the covid-19 pandemic, Confotur extended the three-year period for starting construction by an additional two years. This extension will apply to all projects approved during 2020 and to those previously approved and operating within the initial three-year term.

Incentives for investors in renewable energy

The Dominican Republic encourages investment in the renewable energy sector. Under Law No. 57-07 on the Development of Renewable Sources of Energy, investors in this sector are granted, among other benefits, the following tax incentives: (1) exemption from payment of import duties and value added taxes on the equipment, machinery and accessories necessary for the production, transmission and interconnection of renewable energy; and (2) the reduction to 5 per cent of the withholding tax for the payment of interest abroad for external financing.

In addition, producers authorised under the law may sell certified emission reductions units in accordance with the Kyoto Protocol.

Incentives for investors in the film industry

The Film Industry Law[3] created a legal framework to promote the development, production, distribution and preservation of movies, television shows, music videos and other audiovisual productions, as well as the construction of film-making studios and cinemas. The most important incentives contemplated in the legislation are exemption from payment of the goods and services tax, income tax exemption for the construction of cinemas and film or recording studios, and a transferable tax credit of 25 per cent of expenditures in the Dominican Republic, subject to certain requirements.

To benefit from these incentives, investors need to be registered and authorised with the Dominican Republic Film Commission, which is the regulatory agency in charge of implementing the law.

General incentives for innovation and competitiveness in manufacture

Law No. 392-07 on Competitiveness and Industrial Innovation, as amended by Law No. 542-14, created an institutional framework to enhance the ability of Dominican industry to compete in international markets by promoting horizontal and vertical integration and granting incentives to qualified operators, such as exemption from customs duties and goods and services tax on raw materials, machinery and capital goods; accelerated depreciation of goods and industrial equipment; and reimbursement of certain taxes to exporters.

To qualify for these incentives, industries must be certified by the Industrial Development and Competitiveness Center (known as ProIndustria), the government agency created to implement Law No. 392-07.

Incentives for international investors

Law No. 171-07 grants foreign nationals who invest a minimum of US$200,000 in the Dominican Republic or who meet certain criteria as retirees special benefits,[4] such as expedited residency in the country, exemption from duty for the importation of household goods, exemption from transfer taxes for the first purchase of real estate, exemption from taxes on dividends and interest, and 50 per cent reduction on property and capital gains taxes.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

Foreign investment in the Dominican Republic is not subject to any prohibitions.

ii Restricted sectors

As indicated above, the Constitution accords foreign and local investors equal treatment under the law; thus, foreign investors are bound by the same rules and regulations as those applicable to local investors.

Therefore, except in very special circumstances, such as in relation to insurance and telecommunications, foreign investment is not subject to a cap or special screening or requirements, and shareholders, partners, members, officers and directors of a Dominican company do not need to be Dominican citizens or residents.

The Insurance Law[5] stipulates a local ownership requirement; therefore, at least 51 per cent of the shareholding participation of local insurance companies must be owned by Dominican citizens.

Similarly, the Telecommunications Law[6] requires that to be a concessionaire of a public broadcasting service, to obtain concessions and the corresponding licences to provide public telecommunications services, the applicant must be incorporated as a legal entity of the Dominican Republic. Furthermore, in the case of public broadcasting services, in addition to the above, the person who has control of the operations and management of the concession company is required to be a Dominican national or naturalised foreigner.

V TYPICAL TRANSACTIONAL STRUCTURES

Dominican company law establishes different business combinations allowing companies to gain control over other companies via a direct acquisition, a spin-off or by joining forces with a competing company through a merger or special purpose vehicle. There are no special requirements or conditions for foreign investors to execute asset purchases or share purchases, other than to present foreign documents duly apostilled and translated into Spanish.

Mergers and acquisitions (M&A) activity is governed by several laws in the Dominican Republic. Along with other sector-specific legislation (e.g., for insurance, banking, telecoms and energy), the following are the main laws to consider in every M&A transaction involving private companies:

- the Companies Law;[7]
- the Bankruptcy and Insolvency Law;[8]
- the Tax Code[9] and its regulations;
- the Labour Code;[10]
- the Competition Law;[11]
- the Intellectual Property Law;[12] and
- the Law on Security Interests in Personal Property, for financing M&A deals.[13]

The acquisition of shares in a company, a business or assets must be governed by local law as long as the company in question is Dominican or the assets are located in the Dominican Republic. If a transfer is executed in the parent company, only the registration of the transfer in the Dominican registries must comply with local law.

The following documents are normally executed at the closing of the transaction: the transaction agreement, a closing checklist, attachments or exhibits, asset transfer authorisations, escrow agreements, consents and authorisations, waivers and any other additional documents, depending on the scope of the operation and sector requirements.

The documents for acquiring shares and businesses are very similar as they both involve a stock or share purchase agreement and minutes approving the sale, which must be registered at both the Mercantile Registry and the Tax Authority. Conversely, if assets subject to registration, such as real estate and vehicles, are sold, sale agreements will be registered at the Title Registry or the Tax Authority, respectively. In these latter cases, minutes from the seller approving the sale will also be required.

Signatures on sale agreements must be legalised by a notary. If the transaction involves foreign documents, they must also be apostilled and translated into Spanish.

The E-Commerce Law[14] established equal standing for electronic documents and hard-copy documents. Judicial precedents have also established equal standing, provided that the electronic data is reliable and auditable. However, for an agreement to be considered as having been agreed electronically and therefore binding and enforceable, companies must complete a process to register their digital signatures with a certifying entity, such as the Chamber of Commerce and Production of Santo Domingo, at the Mercantile Registry office before signing the agreement.

VI OTHER STRATEGIC CONSIDERATIONS

There are no references in Dominican law to the possibility of the government influencing or restricting the conclusion of business combinations or acquisitions other than for reasons of national security.

Nevertheless, certain industries require approval from specific regulators or governmental bodies regarding the origin of funds, irrespective of whether it is a national or a foreign investment, including, among others, the following cases:

- authorisation of the monetary board is required in cases of M&A transactions involving financial entities whenever the acquisition represents a percentage equal to or greater than 30 per cent of the paid-in capital. Authorisation is also required in the event of the transfer of all or a substantial part of the assets and liabilities of financial intermediation entities;
- prior approval from the Dominican Institute of Telecommunications (INDOTEL) pursuant to INDOTEL Resolution No. 022-05, approving the regulation of free and fair competition for the telecommunications sector (as amended by Resolution No. 025-10). Approval by INDOTEL is required for all M&A involving telecommunications companies. No thresholds apply;
- the General Electricity Law[15] establishes that M&A activity between energy generation companies is controlled and supervised by the Superintendency of Electricity, which must approve any M&A transactions;
- according to the Insurance Law, insurers and reinsurers may merge subject to prior authorisation from the Superintendency of Insurance. Similarly, authorisation from the Superintendency of Insurance is required for the acquisition of all or part of the client portfolio of an insurer or reinsurer; and
- the Mining Law[16] establishes that all contracts regarding mining transactions, including transfers of mining rights, must be registered at the Public Registry of Mining Rights.

VII OUTLOOK

Recent changes to the legal framework concerning insolvency matters, movable asset warranties, competition law, customs law, anti-money laundering legislation and trust law, and the new rules for mining and energy public procurement frameworks have produced a positive effect, strengthening the country's position in the sector and increasing FDI in the country.

Moreover, on the international trade front, the Dominican Republic has historically taken advantage of its strategic geographical position to establish itself as a regional leader for companies looking to offshore their production and services capabilities abroad. Recently, this trend has increased even further as a result both of the global effects of the covid-19 pandemic and of the dynamism evidenced by the Dominican Republic's economy compared with its regional counterparts. This clear message of robust growth, macroeconomic stability and overall solidity has fostered the Dominican Republic's competitive advantage and increased its attractiveness in terms of nearshoring opportunities in the region.

Furthermore, new rules and regulations in the insurance and financial markets will attract new FDI activity into these sectors. In addition, the tourism industry continues to receive significant attention because of the Dominican Republic's strategic position and the steadily increasing growth seen in this market. Finally, the inflow of new capital from Latin America in the consumer sector indicates that there will be significant activity in this field in the near future.

Lastly, there are also several bills before Congress that will have a positive effect on FDI in the Dominican Republic, namely:

- a reform of the Labour Code;
- a reform of the Code of Civil Procedure; and
- a major reform of the Civil Code.

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Endnotes

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2 Law No. 56-07 Declaring the Textile, Clothing and Accessories Chain a National Priority Sector.
3 Law for the Promotion of Cinematographic Activity in the Dominican Republic, No. 108-10.
4 Law No. 171-07 on Special Incentives for Foreign Pensioners and Investors.
5 Law No. 146-02 on Insurance and Bonds of the Dominican Republic.
6 The General Law on Telecommunications, No. 153-98.
7 The General Law on Companies and Limited Liability Individual Enterprises, Law No. 479-08.
8 Law No. 141-15 on Restructuring and Liquidation of Commercial Companies and Individuals.
9 Law No. 11-92 approving the Tax Code of the Dominican Republic.
10 The Labour Code of the Dominican Republic (Law No. 16-92 of 29 May 1992).
11 Law No. 42-08 on the Defence of Competition.
12 Law No. 20-00 on Industrial Property.
13 Law No. 45-20 on Security Interests in Personal Property.
14 Law No. 126-02 on Electronic Commerce, Documents and Digital Signatures.
15 The General Electricity Law and its Implementing Regulations, No. 125-01.
16 Law No. 146-71, the Mining Law of the Dominican Republic.

Chapter 7

Egypt

Mohamed Hashish, Farida Rezk and Nadine Diaa[1]

Summary

I OVERVIEW

The Egyptian government's extensive efforts in improving the business environment in the country over the past few years have meant that Egypt has managed to attract more foreign direct investment (FDI) across multiple industries, predominantly within the fintech and infrastructure sectors. This achievement has been supported by a plethora of international recognition. Egypt was recognised as one of the top five destinations globally for greenfield FDI in 2016, with Cairo also ranked among the top 10 cities hosting start-ups that year. According to The fDi Report 2020, Egypt replaced South Africa as the second top destination by project numbers in the Middle East and North Africa (MENA) region, experiencing an increase of 60 per cent, up from 85 to 136 projects. Egypt also secured first place among all MENA countries ranked by capital investment in 2020, with 12 per cent capital investment at a total value of US$13.7 billion and with financial services among the top five sectors in the country in 2019.

The Egyptian market's credentials (including investment costs, staffing, and local and market demands) are very attractive to all businesses at all levels from start-ups to large multinational entities.

Despite international and local crises faced by the country over the years (including revolutions, covid-19, the Ukraine–Russia war, inflation and the threat of potential recession), Egypt has somehow maintained strong liquidity and financial status as a result of its FDI performance.

Two of the main sectors attracting FDI in Egypt are fintech and infrastructure. During the past few years, fintech has become increasingly dominant within the Egyptian market, as the most popular business models in the Egyptian jurisdiction are payment platforms and financing services. According to several reports, digital payments will be the market's dominant segment by 2025. In addition, over the past five years, investments pumped into the fintech sector, including fintech-enabled start-ups, reached US$250 million. Investments in this sector reached nearly US$159 million in 2021, compared with just US$900,000 in 2017, according to The fDi Report 2020.

Also, according to a report by FinTech Egypt, a platform that connects the ecosystem's stakeholders, in the first half of 2022, the fintech sector saw a twelvefold increase compared with 2017, including five deals with investments amounting to approximately US$10 million.

The infrastructure sector has also grown significantly over the past 10 years as a result of projects that have been both planned and implemented in the country, as well as changes to and upgrading of roads. Egypt has also completed infrastructure projects totalling 1.7 trillion Egyptian pounds in less than two years.

Generally, the Investment Law No. 72 of 2017 (the Investment Law) and its Executive Regulation, issued in Prime Ministerial Decree No. 2310 of 2017 (the Executive Regulation), are the primary laws and regulations that govern and regulate FDI in Egypt, along with other laws, regulations and a number of bilateral investment treaties (BITs) and double taxation treaties between Egypt and other countries, which aim to improve and encourage foreign investments in Egypt and protect non-Egyptian investors.

The General Authority for Investment and Free Zones (GAFI) is the main competent authority that regulates and facilitates investments in Egypt and promotes the country as a safe environment locally, regionally and internationally, thereby also stimulating investment. Furthermore, GAFI also monitors and reviews FDI by requiring non-Egyptian-owned companies to submit a report consisting of information and data regarding their non-Egyptian participation (FDI Data) on dates determined by Decree No. 2731 of 2019, to establish statistics showing investment inflow, trends and developments.

II YEAR IN REVIEW

According to multiple media sources, Egypt's investment in infrastructure projects over a period of seven years reached US$500 billion.

The government is in the process of completing a number of megaprojects, including (1) the New Administrative Capital, the first phase of which has a total area of approximately 44.1 square kilometres and a total construction value of 20 billion pounds; (2) a new 4.4 billion-pound line for the third phase of the metro, the fourth phase of the metro (at a cost of US$1.2 billion) and the country's first skytrain (valued at US$1.5 billion); (3) the Zohr gas field, which is the largest ever natural gas field discovered in the Mediterranean Sea; (4) Benban Solar Park, which is a photovoltaic power station under construction, with a planned total capacity of 1,650MWp, making it the largest solar installation in the world; (5) El Dabaa Nuclear Power Plant, which is the first nuclear power plant planned for Egypt; (6) the world's sixth largest high-speed rail system (with a total value of US$8.7 billion); and (7) implementing a plan to upgrade sea ports and promote international trade, with an approximate overall value of US$4 billion.

Furthermore, Egypt Vision 2030 began in 2016 with the launch of the economic reform programme (ERP), aimed at improving living standards in various areas, including the economy. Egypt launched the second phase of the ERP in April 2021, focusing on structural reforms such as transforming the economy into a productive economy, increasing its resilience and its ability to absorb external and internal shocks, both to encourage investment and to improve the economy overall.

With regard to recently issued legislation, the Prime Minister issued Decree No. 982 of 2022 encouraging investment and expediting relevant procedures. According to Decree No. 982 of 2022, all competent authorities receiving requests from investors for necessary licences, approvals or permits to establish or start investment project activities must respond to such requests within 20 working days of the submission date, provided that all documents submitted are complete. The competent authorities must respond with a rejection or approval via registered correspondence with acknowledgement of receipt or through modern communication methods agreed with the investor upon submission of the request.

Furthermore, one of the investment incentives announced by the government to attract FDI is the 'golden licence' or unified approval. According to the Investment Law, companies that obtain a golden licence are granted a one-time approval to establish, operate and manage a specific project, and to receive the licences required to establish the necessary facilities, without the need for the multiple approvals and procedures ordinarily required by government authorities. For investors to obtain a golden licence, a number of conditions must be satisfied. It is worth noting that, as at May 2023, 15 licences have been issued to investment projects in Egypt.

It is also worth noting that recent amendments have been made to the Executive Regulation of the Investment Law to promote FDI. Such amendments include the relaxation of certain requirements and permitting the Cabinet to approve establishing projects in the private free zones subject to various conditions as stipulated under the said amendments. Further, the said amendments have relaxed some of the requirements for establishing projects in the private free zones.

III FOREIGN INVESTMENT REGIME

i Policy

Foreign investments are subject to screening in Egypt based on specific criteria, including the investor's nationality and the company's activities, as activities carried out by non-Egyptian investors, as well as the investor's nationality, may be restricted by relevant Egyptian laws and may require certain conditions to be met. Therefore, screening must be performed to ensure the satisfaction of these conditions and requirements. Foreign ownership restrictions are applicable in several sectors and locations:

- conducting importation activities for resale or trading purposes and commercial agencies or intermediary businesses; and
- carrying out business in the Sinai Peninsula.

A security clearance must be obtained for any foreigner to work or do business in Egypt. In practice, GAFI usually approves changes in shareholding structures without requiring a security clearance, except in the case of certain nationalities, such as China, Russia, Ukraine, Nigeria, Israel, Iran, Belarus, Bangladesh, Iraq and Palestine. These restricted nationalities require an advance security clearance. However, it is worth noting that GAFI has started to relax the conditions of obtaining the security clearance prior to incorporation with respect to some nationalities.

Additionally, under Egyptian law, foreign investments are subject to review and screening by GAFI. All companies incorporated in Egypt that are entirely or partially owned by non-Egyptian investors (collectively, non-Egyptian-owned companies), regardless of the percentage of the ownership or the applicable legal regime, must regularly submit their FDI Data to GAFI, pursuant to Decree No. 2731, as follows:

- within 30 days of the incorporation date or the date of any change in the non-Egyptian-owned company's capital, purpose, shareholding structure or board members (as the case may be);
- within 45 days of the end of each quarter of the calendar year; and
- within four months of the end of the relevant non-Egyptian-owned company's financial year.

Furthermore, failure to satisfy the FDI requirement will entail a penalty of 50,000 pounds for non-Egyptian-owned companies, in accordance with the Investment Law.

ii Laws and regulations

The main law governing investment matters in Egypt is the latest Investment Law and its Executive Regulation. The Investment Law provides features that will attract more FDI into Egypt and will improve the investment climate by providing guarantees for all types of investment projects, to ensure fair and equitable treatment of both local and foreign investors without discrimination. In addition, the Investment Law provides general and additional incentives for investors, subject to approval by the Prime Minister, including granting a residence permit to foreign investors throughout the term of their investment projects in Egypt; the right to repatriate profits or receive international finance without any restrictions, subject to the terms of the applicable BIT (if any); the right to import directly raw materials, equipment, spare parts or transportation means as necessary for investment projects without requiring registration with the Importation Registrar; a tax reduction of up to 80 per cent of the paid-in capital on the date of commencing investment projects in Egypt, for a term of seven years; the establishment of a special customs gate for imports and exports relating to an investment project; the allocation of plots of land free of charge for strategic business activities; and other incentives.

In accordance with the Investment Law, there are various investment systems under which investors can choose to operate. Each of these provides certain benefits to investors, including tax and approval benefits. These systems include, mainly, the internal investment system, the free zones system, the private free zones system, the investment zones system and the technological zones system.

There are also other laws that should be considered in relation to foreign investment in Egypt, including the following:

- Companies Law No. 159 of 1981 and its Executive Regulation (the Companies Law), which form the basis for assisting investors in establishing their business in Egypt and facilitating market entry. It applies to domestic and foreign investments in any sector that take the form of joint-stock companies (JSCs), limited liability companies (LLCs) or companies limited by shares; and
- Bankruptcy Law No. 11 of 2018, which regulates corporate bankruptcy and preventive reconciliation and which introduced the out-of-court restructuring system.

As part of the applicable regimes, Egypt also has many BITs and DDTs in place to facilitate and protect FDI in Egypt. The terms and conditions of each specific treaty in relation to FDI in Egypt should always be taken into consideration.

iii Scope

In accordance with the Executive Regulation, the following investment activities are, in general, subject to the provisions of the Investment Law: manufacturing, wholesale and supply chains, education and health, transportation, tourism, agriculture, housing and construction, sports, natural resources and petroleum, electricity, telecommunications and technology.

iv Voluntary screening

Voluntary screening is not applicable and not regulated by Egyptian law.

v Procedures

GAFI reviews FDI developments and progress through the periodic FDI reports submitted regularly by non-Egyptian-owned companies (see Section III.i).

vi Prohibition and mitigation

Information on this topic is not publicly available.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

There are a few sectors that are either partially or entirely restricted in Egypt with regard to foreign investment, such as carrying out business activities in the Sinai Peninsula.

ii Restricted sectors

Foreign investment in certain activities and within some sectors is restricted, and certain requirements must be satisfied for a foreign investor to be able to perform these activities under the relevant Egyptian laws.

As a general rule, according to the Importers Registrar Law, no person, whether natural or juristic, may import any product for trading purposes unless (1) the person is registered with the Importers Registrar, (2) at least 51 per cent of the company's share capital is owned by Egyptian nationals, or (3) an Egyptian manager is appointed to maintain responsibility for any importation activities. However, foreign investors can still achieve full control over this type of business by using a specific structure.

Furthermore, in accordance with the Commercial Agencies Law, commercial agency-related activities may be carried out by companies that are 100 per cent owned by Egyptian nationals. However, foreign investors can still achieve full control over this type of business by using a specific structure. Notably, in accordance with the Companies Law, non-Egyptian employees' total salaries in any entity subject to this Law (such as JSCs, LLCs and one-person companies (OPCs)) must not exceed 20 per cent of the total salaries of all employees working for the same entity.

However, according to the Executive Regulation, an increase in the maximum ratio for foreign employees, from 10 per cent to 20 per cent, can be authorised for companies established under the provisions of the Investment Law, provided that (1) approval is obtained from the Ministry of Manpower and (2) there is no possibility of employing Egyptian personnel with the necessary qualifications.

V TYPICAL TRANSACTIONAL STRUCTURES

There are several corporate structures for ownership regulated by the Companies Law, including the following.

i JSC

This type of private company resembles a US corporation and a French *société anonyme*, and it can be either a publicly listed company or a closed company.

The share capital of a JSC must be owned by at least three shareholders, of any nationality. The incorporation of a JSC requires a minimum capital of 250,000 pounds if the JSC is not to be publicly listed on the Egyptian Stock Exchange.

ii LLC

This type of company corresponds to the French *société à responsibilité limitée* and is similar to an incorporated partnership or a US closed company.

According to the Companies Law, the share capital of an LLC must be owned by at least two partners, who can be individuals or juristic persons of any nationality. In general, there is no minimum capital requirement under Egyptian law with respect to the incorporation of an LLC unless otherwise required by law or by virtue of a decision from the competent supervisory authority. However, in all cases, the issued capital of an LLC must be paid in full upon application for incorporation.

iii OPC

OPCs can be owned by either a natural or a juristic person. However, OPCs are not permitted to carry out the following activities:

- incorporating another OPC;
- public offerings;
- dividing their share capital into transferable shares;
- receiving finance by issuing bonds; and
- similarly to LLCs, conducting any business activities relating to insurance, banking, savings, receiving funds and investment management.

Prior to acquiring any assets or shares in Egypt, foreign investors should consider a number of issues under Egyptian law, such as the terms and conditions of any BIT or DDT of relevance to the direct acquiring entity's jurisdiction, as well as any necessary security clearances applicable to that jurisdiction.

VI OTHER STRATEGIC CONSIDERATIONS

It is worth noting that in light of the recent amendments to the Competition Law,[2] in late 2022, the pre-closing clearance for any transaction has been newly introduced as opposed to the post-notification regime. Such pre-approval is required for any transaction that constitutes an 'economic concentration'. Under the new amendments, economic concentration is defined as any change of control or material influence as a result of a merger or acquisition or establishment of a joint venture. However, the process and applicability of the newly introduced regime are still subject to the issuance of the Executive Regulation for the said Competition Law.

VII OUTLOOK

The International Monetary Fund expects FDI in Egypt to rise over the next two years to US$11.7 billion in financial year 2022–2023 and US$16.5 billion in financial year 2024–2025. In addition, FDI as a percentage of GDP is predicted to be 2.9 per cent in 2023–2024 and 3 per cent in 2024–2025.

Also, Fitch Ratings, the American credit rating agency, has confirmed that the Egyptian economy's stability will attract more FDI in the non-oil sectors over the coming years.

Major investment projects such as Honeywell International's investment in Egypt are also expected to launch in the near future, enhancing the investment climate in Egypt.

It is also worth noting that it is reported that amendments will be made to the Investment Law whereby all investment projects established by virtue of the provisions of the Investment Law may apply for the golden licence without any set conditions. It is worth noting that the golden licence grants investment projects a single approval for the establishment, operation and management of the project, with no need to obtain any further licences.

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Chapter 8

EU Overview

Frank Röhling and Uwe Salaschek[1]

I INTRODUCTION

The EU framework for the screening of foreign direct investment (FDI) into the European Union (the EU FDI Screening Regulation)[2] entered into force on 10 April 2019 and became fully applicable on 11 October 2020.[3] The inception of this Regulation is linked to concerns of certain Member States, spearheaded by France, Germany and Italy, that foreign investors – especially state-owned enterprises investing as part of a strategic industrial policy – may acquire critical assets and key technologies from EU companies, in particular when there are no reciprocal rights to invest in the country from which the FDI originates.[4] Against this background and after intense political debates, the European Commission (the Commission) and the Member States put in place the EU FDI Screening Regulation with the aim of preserving the European Union's strategic interests while at the same time keeping the EU market open to investment.

The EU FDI Screening Regulation emphasises the open investment environment of the European Union and its Member States. It highlights the advantages of FDI in light of key interests of the European Union, such as enhancing competitiveness; creating jobs and economies of scale; bringing in capital, technologies, innovation and expertise; and, more generally, contributing to the European Union's growth and opening markets for the European Union's exports.[5] However, it clarifies that for the purpose of protecting security or public order, it is possible for the European Union and the Members States to adopt restrictive measures relating to FDI, as is also established in Point (b) of Article 65(1) of the Treaty on the Functioning of the European Union.[6]

The EU FDI Screening Regulation provides a framework for FDI screening mechanisms at Member State level to ensure legal certainty and EU-wide coordination and cooperation. It does not introduce a centralised FDI screening mechanism and there is no 'one-stop shop' mechanism in the European Union that would allow the Commission to make its own decisions or even to block FDI into the European Union. The Commission rather assumes a coordination role but does not act as a decision maker. It remains the sole responsibility of the Member States to safeguard their national security and public order.[7] In theory, the Member States are free to decide whether they want to set up an FDI screening mechanism or to screen a particular FDI.[8] However, in practice, the Commission has made it quite clear that it expects all Member States to have a national screening mechanism in place.[9]

The EU FDI Screening Regulation increases harmonisation within the European Union by creating a framework for national FDI screening mechanisms (see Section II, below). The Regulation's centrepiece is a cooperation mechanism between the Member States and the Commission (see Section III, below). This chapter concludes with a short summary of current developments and a brief look at the future of EU FDI (see Section IV, below).

II FRAMEWORK FOR MEMBER STATES' FDI SCREENING MECHANISMS

FDI is defined as an investment of any kind by a foreign investor that aims to establish or to maintain lasting and direct links between the foreign investor and the target company to carry on an economic activity in a Member State, including investments that enable effective participation in the management or control of a company carrying out an economic activity.[10] This definition excludes portfolio investments.[11]

In its *Xella* judgment, the first case dealing with national restrictions of FDI since the implementation of the FDI Screening Regulation, the Court of Justice of the European Union (CJEU) clarified that the EU FDI Screening Regulation is not applicable in cases where the direct acquirer is based in the European Union, even if the acquirer has non-EU-based shareholders (except in cases of circumvention, which has been traditionally interpreted narrowly by the CJEU).[12] But many Member States will still screen such investments under their national rules.

The procedural and substantive framework, inter alia, aims at increasing transparency for the benefit of investors, the Commission and other Member States.[13] Unlike the EU Merger Regulation,[14] the EU FDI Screening Regulation does not establish a one-stop shop in the case of multi-jurisdictional screening procedures across several Member States.

Although it is left to Member States as to whether to introduce FDI screening mechanisms, they must notify the Commission of any existing or newly introduced FDI screening mechanism. The Commission regularly publishes an updated list of the existing screening mechanisms within the European Union.[15] In addition, Member States are obliged to submit annual reports to the Commission that include information not only on the FDI that took place in their territory in the preceding year and any requests received by other Member States in the context of the cooperation mechanism but also on the operation of their national screening mechanism.[16] On that basis, the Commission is required to submit an annual report to the European Parliament and the European Council on the implementation of the EU FDI Screening Regulation.[17] The first such report was published in November 2021[18] and the second report followed in September 2022.[19]

i EU requirements for Member States' screening mechanisms

Article 3 of the EU FDI Screening Regulation establishes certain minimum requirements for Member States' screening mechanisms, namely:

- rules and procedures shall be transparent and non-discriminatory between third countries (Paragraph 2);
- screening mechanisms shall set out triggering events for the screening, the ground for screening and detailed procedural rules, including time frames (Paragraphs 2 and 3);
- confidential information made available to the Member States shall be protected (Paragraph 4);
- foreign investors and undertakings concerned shall have the possibility to seek recourse against screening decisions of national authorities (Paragraph 5); and
- the screening mechanisms shall include measures necessary to identify and prevent circumvention of the screening mechanism and screening decisions (Paragraph 6).

As can be seen from the list above, there remains considerable scope for Member States to determine the details of their respective FDI screening procedures, which at the same time means that there is limited harmonisation within the European Union. As a consequence, investors need to be aware of the national particularities of different FDI screening procedures in all Member States where they are planning cross-border mergers and acquisitions.

ii EU suggestions for Member States' substantive test

The EU FDI Screening Regulation includes a list of factors that can be taken into consideration by a Member State when determining whether FDI is likely to affect security or public order. These factors relate to the activities of the target company and the identity of the foreign investor.

Activities of the target

The EU FDI Screening Regulation lists a number of sectors that may trigger an FDI review:

- critical infrastructure (e.g., energy, transport, water, health, communication or defence);
- critical technologies and dual-use items (e.g., artificial intelligence, robotics, semiconductors, cybersecurity, nuclear technologies and nanotechnologies);
- supply of critical inputs (e.g., raw materials and food safety);
- access to sensitive information (including personal data) or the ability to control such information; or
- freedom and pluralism of the media.[20]

The list is non-exhaustive and Member States may have rules for additional sectors depending on national specificities. At the same time, the terms used by the EU FDI Screening Regulation (such as 'critical infrastructure', 'artificial intelligence' and 'robotics') are very broad and leave ample room for interpretation. In any case, the prohibition or restriction of FDI requires a 'genuine and sufficiently serious threat to a fundamental interest of society', as it constitutes a restriction of fundamental freedoms.[21] In practice, many Member States apply more specific definitions of the factors that are being considered when screening FDI into their territory. This exemplifies the balance to be struck by the EU FDI Screening Regulation between preserving the sole responsibility of Member States for safeguarding their national security on the one hand and providing legal certainty and unionwide coordination on the other hand.

Identity of the investor

As regards the identity of the foreign investor, factors to be considered in the context of the substantive FDI assessment include whether the foreign investor is controlled by the government of a third country, whether the foreign investor has already been involved in activities affecting security or public order in a Member State, and whether there is a serious risk that the foreign investor is engaging in illegal or criminal activities.[22] As mentioned above, FDI rules and procedures shall be non-discriminatory between third countries[23] but, in practice, (state-owned) investors from certain (non-EU and non-NATO) countries (e.g., China or Russia) may be more likely to face increased scrutiny than others.

III COOPERATION MECHANISM

The EU FDI Screening Regulation provides for a framework for the Commission to issue opinions and Member States to provide comments on FDI in the territory of (other) Member States:[24]

- the Commission may issue an opinion if it considers that the transaction is likely to affect security or public order in more than one Member State, if the Member State in which the transaction is taking place has asked the Commission to do so, or the Commission has information relevant to the transaction. Where at least one-third of Member States consider that the transaction is likely to affect their security or public order, the Commission shall issue an opinion;[25] and
- Member States may submit comments if they consider that the transaction is likely to affect their security or public order, or if they have information relevant to the FDI screening.[26]

In addition, the EU FDI Screening Regulation explicitly mentions the possibility of Member States and the Commission cooperating with the responsible authorities of third countries on grounds of security and public order.[27]

With a view to cooperation within the European Union, different rules apply to the following:

- FDI that is undergoing screening in the Member States in which it takes place;
- FDI that is not undergoing screening; and
- FDI that is likely to affect projects or programmes of EU interest.

i FDI undergoing screening

Under the EU FDI Screening Regulation, Member States must inform the Commission and other Member States as soon as possible about FDI in their territory that is undergoing screening and, without undue delay, provide certain information, which some Member States request from the notifying parties from the outset via a standard form. The information that is required includes details about:

- the ownership structure of the foreign investor and of the target company;
- the approximate value of the FDI;
- the activities of the foreign investor and of the target company;
- the Member States in which the foreign investor and target company are active;
- the funding of the investment and its source; and
- the date on which the FDI is planned to be completed or has been completed.[28]

Within 15 calendar days of receipt of the notification and the relevant information, the Commission and the other Member States must inform the Member State undertaking the screening of their intention to provide comments (in the case of Member States) or an opinion (in the case of the Commission).[29] To the extent necessary for their review, the Commission and the other Member States may request additional information from the Member State, which shall provide it to them without undue delay.[30] In practice, this can lead to delays, for example where an authority must first obtain the information from other government agencies or third parties with no statutory deadlines applying. The Commission reports that in the case of requests for additional information, Member States took an average of 22 calendar days to respond (compared with 31 calendar days in the first report), with, however, a significant, nearly unchanged range from three to 101 days.[31] It is to be hoped that such long delays will remain the exception.

On the basis of the above, 15 calendar days is the minimum time that the process under the cooperation mechanism could take in the event that neither a Member State nor the Commission makes a submission or requests any additional information. Otherwise, the Commission must issue an opinion and the Member States must provide comments within 35 calendar days of receipt of the information outlined above (this may be extended to 40 calendar days for Commission opinions).

If further information is requested, comments by Member States or an opinion by the Commission shall be issued no later than 20 calendar days following receipt of the additional information.[32]

Although the final decision to clear a transaction, request remedies or block the FDI remains with the Member States undertaking the screening, they shall give due consideration to the comments of other Member States and to the opinion of the Commission, unless immediate action is required.[33]

In practice, the obligation of Member States to 'stand still' and take a final decision only after they have received comments or opinions can lead to significant delays. For investors, the cooperation mechanism remains a 'black box' and there is a lack of transparency with a view to the potentially significant effect on deal timetables. The terms used by the EU FDI Screening Regulation are partially opaque (e.g., the notions of 'without undue delay', 'as soon as possible' or to 'give due consideration') and, for the investor, there is no visibility on which authority of which Member State requests which information about the planned FDI and for which reason. The Commission communicates exclusively with the Member States that remain the sole point of contact for the notifying parties. In practice, this can lead to a lack of transparency and frustrating delays, which raises questions with a view to the principle of due process and the investors' rights of defence.

ii FDI not undergoing screening

Even FDI that is not undergoing screening may be subject to comments of other Member States or to an opinion of the Commission, to which the Member State where the FDI is planned or has been completed shall give due consideration.[34] If the FDI has not completed, the relevant Member State could either decide to review the transaction under its domestic screening regime or use any other instruments available to it under domestic laws (if it does not have an FDI screening regime in place). If the FDI has already completed, the Member State may decide to act, depending on what powers are available to it under national law.

There is a time limit for providing submissions on completed FDI of 15 months after completion.[35] This also applies to transactions that completed prior to 11 October 2020.

There are no thresholds in relation to unscreened transactions under which the cooperation mechanism could not be applied. Therefore, even transactions that are not notifiable in a Member State in which they take place may be subject to information requests or be commented or opined upon. The only requirement is that a Member State and the Commission duly justify their information requests and ensure that they are proportionate, limited in scope to information necessary to comment or opine and not too burdensome for the Member State in which the transaction takes place. Member States and the Commission must also duly justify their respective comments and opinions and explain why the FDI is likely to affect the security and public order of other Member States.[36]

iii FDI likely to affect projects or programmes of Union interest

If the FDI is likely to affect projects or programmes of Union interest, a slightly modified cooperation procedure applies and, in particular, the Member State where the FDI is planned or has been completed shall take 'utmost account' of the Commission's opinion and provide an explanation to the Commission if its opinion is not followed.[37] The relevant projects and programmes of EU interest are set out in the Annex to the EU FDI Screening Regulation. Following an amendment in September 2021,[38] the Annex now includes the following:

- European GNSS programmes (Galileo & EGNOS);
- Copernicus;
- Preparatory Action on Preparing the new EU GOVSATCOM programme;
- Space Programme;
- Horizon 2020;
- Horizon Europe;
- Euratom Research and Training Programme 2021-25;
- Trans-European Networks for Transport (TEN-T);
- Trans-European Networks for Energy (TEN-E);
- Trans-European Networks for Telecommunications;
- Connecting Europe Facility;
- Digital Europe Programme;
- European Defence Industrial Development Programme;
- Preparatory Action on Defence Research;
- European Defence Fund;
- Permanent structured cooperation (PESCO);
- European Joint Undertaking for ITER; and
- EU4Health Programme.

IV CURRENT DEVELOPMENTS AND OUTLOOK

Although the EU FDI Screening Regulation is a relatively new instrument, its effects on FDI screening in the European Union can hardly be overstated. To date, 19 national screening mechanisms have been notified to the Commission.[39] Another six Member States are currently in the process of adopting screening mechanisms,[40] whereas only Bulgaria and Cyprus remain without any ongoing initiative.[41] The trend of implementing national screening mechanisms has further accelerated since the Russian aggression against Ukraine in February 2022. In its communication on guidance to the Member States concerning FDI from Russia and Belarus,[42] the Commission calls on Member States 'urgently to set up a comprehensive FDI screening mechanism' and to 'implement fully the FDI Screening Regulation, including through active participation in the cooperation mechanism between Member States and between them and the Commission'.[43]

Many Member States follow the European Union's suggestion regarding which sectors to review. This has led to some convergence between national review mechanisms. However, varying definitions (or the lack thereof) for the same terms still necessitate detailed analyses and separate filings under every country's rules. This is understandable because FDI screening regimes relate to public order and security – an area for which the legislative competence remains with the Member States.[44]

Almost three years of experience with the cooperation mechanism show that the system works efficiently in most cases. According to the 'Second Annual Report on the screening of foreign direct investments into the Union', in 2021, the Commission counted 414 notifications from 13 Member States, of which 85 per cent were submitted by Germany, France, Italy, Austria and Spain. The number of notifications increased significantly compared with the previous year, when 265 notifications were submitted. Of the 414 notifications, 86 per cent were cleared by the Commission without issuing an opinion or request for further information. In only 11 per cent of cases, the Commission requested additional information; in 3 per cent of cases, the Commission issued an opinion.[45]

In practice, the regular exchange of information among the Member States and the Commission seems to result in higher scrutiny at a national level. Particularly those Member States actively participating in the cooperation mechanism were seen to initiate *ex officio* investigations or to approach the parties in cases where the FDI was not notified to the respective Member State. Parties are advised to consider the effects of the information exchange in their filing strategy early on to avoid unexpected delays at a later stage.

To ensure that FDI review does not become overly burdensome for investors, it would be preferable if the Commission were to introduce strict rules on timing for Member States' cooperation. This would help increase foreseeability and, ultimately, legal certainty. Other points where harmonisation would be beneficial include:

- aligned definitions in specific sectors to ensure that all Member States review the same kinds of transactions;
- the duration of national reviews;
- the types of remedies that national authorities require to clear transactions; and
- transparency with respect to the correspondence between the Commission and Member States, which would allow investors and target companies to comment to resolve open questions.[46]

The Commission is currently evaluating the functioning and effectiveness of the EU FDI Screening Regulation and will present a report to the European Parliament and European Council by the end of 2023. As the evaluation aims to ensure that the EU FDI Screening Regulation remains fit for purpose in a changing global security context, the Commission may propose a revision of the rules depending on the outcome of the current consultation.[47] Changes in order to address the points mentioned above would be welcomed by investors and practitioners alike.

In addition to the screening of FDI, the European Union is currently in the process of implementing a mechanism granting the European Commission the ability to investigate and enforce against non-EU subsidies in a range of scenarios: the new Foreign Subsidies

Regulation (FSR). The FSR applies from 12 July 2023 and aims to ensure a level playing field in the European Union for companies that receive foreign subsidies and those that do not by closing a perceived regulatory gap (since the EU State Aid rules apply only to financial support granted by EU Member States).

In terms of practical implications, the FSR includes the introduction of a new mandatory and suspensory deal notification obligation in the European Union, which will apply to transactions that have not closed prior to 12 October 2023 (if signing happened on or after 12 July 2023). This notification obligation applies where either the target, the joint venture or one of the merging parties is established in the European Union and generates an aggregate turnover of at least €500 million in the European Union, and the parties involved have received in aggregate financial contributions (including grants, loans, tax breaks or ordinary course remuneration for any form of contracting with non-EU governments, their departments or other public bodies or state-owned enterprises) exceeding €50 million from non-EU countries over the previous three years.

In future, businesses will therefore need to carry out an FSR filing analysis at the same time as equivalent analyses for merger control and FDI filings. While the notification forms are still to be finalised, this review process will likely entail extensive disclosure requirements in relation to the financial contributions received. Furthermore, the same gun-jumping rules and fines apply as under the EU Merger Regulation.

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Endnotes

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2 Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019, establishing a framework for the screening of foreign direct investments into the Union, OJ L 79 I, 21.3.2019 (EU FDI Screening Regulation), pp. 1–14.
3 See EU FDI Screening Regulation, Article 17.
4 See corresponding letters from the French, German and Italian governments submitted to the European Commission setting out their concerns, available at https://www.bmwk.de/Redaktion/DE/Downloads/E/eckpunktepapier-proposals-for-ensuring-an-improved-level-playing-field-in-trade-and-investment.html (last accessed 30 June 2023).
5 EU FDI Screening Regulation, Recital 1 *et seq*.
6 ibid., Recital 3 *et seq*.
7 See Treaty on European Union, Article 4(2); Treaty on the Functioning of the European Union, Article 346.
8 See EU FDI Screening Regulation, Articles 1 and 3(1) and Recitals 7 and 8.
9 See, e.g., Trade Policy Review – An Open, Sustainable and Assertive Trade Policy, COM(2021) 66 final – 18 February 2021, available at https://eur-lex.europa.eu/resource.html?uri=cellar:5bf4e9d0-71d2-11eb-9ac9-01aa75ed71a1.0001.02/DOC_1&format=PDF (last accessed 30 June 2023).
10 EU FDI Screening Regulation, Article 2, Paragraph 1.
11 See ibid., Recital 9.
12 Case C-106/22 *Xella Magyarország* [2023] ECLI:EU:C:2023:568, Paragraph 37.
13 See also ibid., Recitals 12 and 15.
14 See Council Regulation (EC) No. 139/2004 of 20 January 2004, on the control of concentrations between undertakings, OJ L 24, 29.1.2004, pp.1–22 (EU Merger Regulation), Article 1 and Article 4, Paragraph 5.
15 EU FDI Screening Regulation, Article 3, Paragraphs 7 and 8. The Commission publishes the list of screening mechanisms notified by Member States, accessible at https://policy.trade.ec.europa.eu/enforcement-and-protection/investment-screening_en (last update: 28 June 2023) (last accessed 30 June 2023)
16 EU FDI Screening Regulation, Article 5, Paragraphs 1 and 2.
17 ibid., Article 5, Paragraph 3.
18 'First Annual Report on the screening of foreign direct investments into the Union', of 23 November 2021, COM(2021) 714 final (First Annual Report), available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021DC0714 (last accessed 29 June 2023).
19 'Second Annual Report on the screening of foreign direct investments into the Union', of 1 September 2022, COM(2022) 433 final (Second Annual Report), available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022DC0433 (last accessed 29 June 2023).
20 See EU FDI Screening Regulation, Article 4, Paragraph 1.
21 Case C-106/22 *Xella Magyarország* [2023] ECLI:EU:C:2023:568, Paragraph 66.
22 See ibid., Article 4, Paragraph 2.
23 ibid., Article 3(2).
24 For this purpose, each Member State and the Commission establish a contact point – see EU FDI Screening Regulation: Article 6, Paragraph 10; Article 7, Paragraph 9; and Article 11.
25 EU FDI Screening Regulation, Article 6, Paragraph 3 and Article 7, Paragraph 2.
26 ibid., Article 6, Paragraph 2 and Article 7, Paragraph 1.
27 ibid., Article 13.
28 See ibid., Article 6, Paragraph 1 and Article 9, Paragraphs 1 and 2.
29 See ibid., Article 6, Paragraph 6.
30 See ibid., Article 9, Paragraph 3.
31 Second Annual Report, p. 17.
32 EU FDI Screening Regulation, Article 6, Paragraph 7.
33 ibid., Article 6, Paragraphs 8 and 9. In exceptional cases, where immediate action is required, the Member State that undertakes the screening must notify the other Member States and the Commission of its intention to issue an immediate decision and, in such a case, the other Member States and the Commission should endeavour to provide comments or to issue an opinion expeditiously.
34 ibid., Article 7, Paragraph 7.
35 ibid., Article 7, Paragraph 8.
36 ibid., Article 7, Paragraph 5.
37 ibid., Article 8
38 Commission Delegated Regulation (EU) 2021/2126 of 29 September 2021, amending the Annex to Regulation (EU) 2019/452 of the European Parliament and of the Council establishing a framework for the screening of foreign direct investments into the Union, OJ L 432, 3.12.2021, pp. 1–6.
39 As at 28 June 2023, the following Member States have notified screening mechanisms to the Commission: Austria, Belgium, the Czech Republic, Denmark, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia and Spain; see the list of screening mechanisms notified by Member States, accessible at https://policy.trade.ec.europa.eu/enforcement-and-protection/investment-screening_en (last accessed 30 June 2023).

40 In Estonia (an FDI screening regime to enter into force in September 2023), Greece, Ireland (a proposal for an FDI screening regime is currently undergoing the legislative process), Luxembourg (an FDI screening regime was adopted in June 2023), Sweden (a proposal for an FDI screening regime is pending approval by the Swedish Parliament) and Croatia, discussions are currently ongoing; see also Second Annual Report, p. 9.
41 Second Annual Report, p. 9.
42 Communication from the Commission, Guidance to the Member States concerning foreign direct investment from Russia and Belarus in view of the military aggression against Ukraine and the restrictive measures laid down in recent Council Regulations on sanctions, of 6 April 2022, OJ CI 151, p. 1.
43 id.
44 See Treaty on the Functioning of the European Union, Article 65(1)(b).
45 Second Annual Report, pp. 14 and 16.
46 For a more detailed overview of suggestions for harmonisation, see Dr Uwe Salaschek, 'Practical Implications of the EU Screening Regulation on National Screening of FDI' (Betriebs-Berater 2022), 1609–1614.
47 See https://policy.trade.ec.europa.eu/consultations/screening-foreign-direct-investments-fdi-evaluation-and-possible-revision-current-eu-framework_en.

Chapter 9

France

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Summary

I OVERVIEW

As a matter of principle, foreign investments are permitted, and even encouraged, in France. However, the French Ministry of the Economy (MOE) is keen to review certain types of foreign investments when they pertain to French interests that are considered sensitive, including, but not limited to, national defence and technological matters or the protection of critical infrastructures.

Over the past few years, review activity under the French foreign investment regime (FFIR) has gathered steam and constitutes a key factor to be assessed carefully when planning a potential transaction.

In fact, from 2014, which marked the beginning of the political acknowledgement that critical or sensitive national assets and knowledge should be kept within some degree of national control, the FFIR has continued to expand, leading to a strengthening of the intervention powers of the MOE. In December 2019, the FFIR was again significantly amended by Decree No. 2019-1590 and the Ministerial Order of 31 December 2019. These changes became applicable to all notifications submitted to the MOE from 1 April 2020. The revamped FFIR notably involves strengthened enforcement powers for the MOE and a larger scope of review, with lower review thresholds and covering a larger list of strategic sectors. It has since taken on a whole other dimension because of the covid-19 pandemic, which revealed the dependence of many strategic sectors (in particular the health sector) on some foreign countries for the production or supply of sensitive products. It also paved the way for implementation of regulation on a European scale, with the full entry into force of the EU screening mechanisms for foreign direct investments, which notably provide for a new cooperation mechanism allowing Member States and the European Commission to exchange information and raise concerns relating to specific investments.

For the government, the FFIR has become instrumental in reviewing and prohibiting all potentially harmful transactions.

II YEAR IN REVIEW

France remains an economically attractive country (according to the latest results of an EY survey, France was the most attractive country in Europe for foreign investment in 2022 for the fourth successive year),[2] registering 1,725 foreign investments in 2022 (an increase of 7 per cent compared with 2021). France has also reported a stable number of reviewed investments: from 328 in 2021 to 325 in 2022.

The recently published MOE 2023 annual report on foreign investment control in France states that, in 2022, most of the controlled investments in France – 65.8 per cent – were made by non-European ultimate controlling investors. As in 2021, the main countries of origin of these ultimate investors were the United Kingdom, the United States and Canada. In 2021, non-EU or EEA ultimate controlling investors represented 58.8 per cent of the controlled investments. Indeed, the MOE makes no real distinction between EU and non-EU or EEA investors. Rather, the analysis is transaction-specific and depends on the nature of the target, the target's relationship with the government, and the sensitivity of its contracts or informational capabilities.

On 9 September 2022, the MOE issued its first guidelines on the regulation of foreign investment control in France. These guidelines, which follow a public consultation launched in March 2022, clarify the interpretation of legislative and regulatory provisions of the FFIR and, in particular, the criteria for identifying a foreign investor and an investment.

On 5 January 2023, the French Minister of the Economy announced that the temporary 10 per cent threshold relating to investments in listed companies will become permanent, with the objective of 'strengthening the protection of our technologies and our companies'. Indeed, from the beginning of the health crisis in 2020, the French government took into account the need to further protect listed French companies carrying out sensitive activities by temporarily lowering (by decree) the 25 per cent notification threshold to 10 per cent for targets that are listed companies when the acquirers are not EU or EEA investors. Given the current economic context linked to the energy crisis, the French government considers that it is still not possible to rule out the risks to these companies. The application of this threshold was therefore extended for the third time by Decree No. 2022-1622 of 23 December 2022 and will apply until 31 December 2023. According to the recently published MOE 2023 annual report on foreign investment control in France, the practical terms of this permanent change will be specified in the course of 2023.

Finally, even though prohibition decisions remain rare, in the past year, the French government sent again a clear message that it is not averse to using its new-found discretionary powers to ensure the protection of national interests. According to public information, the French Ministry of the Armed Forces would have opposed the acquisition of Segault (a French company that notably supplies valves for the on-board nuclear boiler rooms of French nuclear submarines) by the American company Flowserve. Indeed, once the transaction is notified by the investor to the French Treasury (a department within the MOE), the latter sends the notification to the relevant administrations and agencies concerned by the investment to collect their comments on the proposed investment. On the basis of this information, as well as its own assessment, the Treasury proposed a decision to the Minister. According to public information, the 'veto' of the French Ministry of the Armed Forces would have led to the 'veto' of the MOE, though there has been no official communication on this alleged prohibition.

III FOREIGN INVESTMENT REGIME

i Policy

When reviewing foreign investments, the aim of the MOE is to ensure that a particular transaction will not threaten the integrity, security and continuity of sensitive activities or services to sensitive French clients; to ensure that sensitive information will be contained; to ascertain that strategic activities and their associated sensitive data will not become subject to foreign legislation; and to maintain the technological standards of the production and industrial capacity of the French entity concerned.

Transactions relating to sensitive sectors are being reviewed with particular scrutiny. Indeed, the pandemic highlighted the dependence of many strategic sectors (especially the health sector) on foreign countries for the production and supply of sensitive products or the supply of products necessary for French production. Against the background of the pandemic, biotechnologies were included in the list of critical technologies covered by the FFIR, and the threshold for non-European investors taking shares in a French listed company was lowered from 25 per cent to 10 per cent. In addition, in an effort to adapt the FFIR to current environmental challenges, technologies involved in the production of renewable energy were also added to the list of critical technologies covered by the FFIR.

As well as the expansion of the legislative arsenal, whose main goal, according to Minister Bruno Le Maire, is to extend the foreign investment review to 'several thousand companies', a tightening of control by the MOE over proposed transactions is to be expected, notably to ensure that companies producing and supplying sensitive products or services will remain in France, and to ensure the supply of sensitive products or services to sensitive clients.

ii Laws and regulations

France's stand-alone foreign investment regime, the FFIR, was established in the Monetary and Financial Code (MFC). Foreign investments in sensitive sectors are subject to prior authorisation of the MOE before completion of the transaction.

The FFIR was significantly revamped by a decree enacted in December 2019. As noted above, this new regime strengthened the MOE's enforcement powers and extended the scope of review. The regime now applies to all authorisation requests submitted from 1 April 2020. It was further amended throughout 2020, 2021 and 2022 as part of the government's attempt to stem the consequences of the covid-19 pandemic and to tackle challenges in the energy sector, in particular by further lowering review thresholds for non-European investors (at least until 31 December 2023) and expanding the strategic sector list to include biotechnology activities and technologies involved in the production of renewable energy.

Once the transaction is notified by the investor to the French Treasury, the latter sends the notification to the relevant administrations and agencies concerned by the investment to collect their comments on the proposed investment. On the basis of this information, as well as its own assessment, the Treasury will issue its decision.

As from 1 January 2022, if an entity in the investor's chain of control is a national of a state outside the European Union, the European notification should be filed at the same time as the filing for prior authorisation. The MOE will transmit the European notification to the European Commission and the Member States to inform them of the transaction and to enable the Commission to issue opinions and Member States to provide comments. In its recent annual report, the MOE states that France is one of the most active European countries in the cooperation with the Commission and other Member States. Similarly, based on the EU Commission 2022 annual report on the screening of foreign direct investments in the Union, France was part of the five states notifying the vast majority (85 per cent) of cases at European level.

iii Scope

A French foreign investment notification is required when the investment transaction meets two conditions: (1) it falls within a type of investment covered by the FFIR and (2) it falls within one of the strategic sectors covered by the FFIR.

Type of investment

The FFIR applies to non-French investors and makes some distinction between European investors and non-European investors that are from neither the European Economic Area nor the European Union (non-EEA or non-EU investors).

The FFIR applies to the following types of investments when they are made by non-French investors:

- the acquisition of control of an entity governed by French law; or
- the acquisition of all or part of a branch of activity of an entity governed by French law (which could constitute intellectual property rights, patents, sensitive contracts, materials, furniture and machinery, etc.).

The notion of control of a company that has its registered office in France is different from the notion of control under competition law and is defined by Article L233-3 of the Commercial Code, which provides that a legal or natural person is deemed to control another when:

- it directly or indirectly holds a share of the capital that grants it the majority of the voting rights at that company's general meetings;
- it alone holds the majority of the voting rights in that company by virtue of an agreement entered into with other partners, members or shareholders that is not contrary to the company's interests;
- it effectively determines the decisions taken at that company's general meetings through the voting rights it holds; or
- it is a partner, a member or a shareholder of that company and has the power to appoint or dismiss the majority of the members of that company's administrative, management or supervisory organs.

Control is presumed when an investor directly or indirectly holds above 40 per cent of the voting rights and no other partner or shareholder directly or indirectly holds a larger share.

Two or more legal or natural persons that act together are deemed to jointly control another company when they effectively determine the decisions taken at general meetings.

The following types of investment covered by the FFIR are applicable only to non-EU or EEA investors:

- exceeding, directly or indirectly, alone or in concert, 25 per cent of the voting rights of an entity governed by French law; and
- exceeding, directly or indirectly, acting alone or in concert, 10 per cent of voting rights of a company registered in France and listed on a regulated market (temporary measure applicable until 31 December 2023, which should soon become permanent).

The above-mentioned temporary 10 per cent threshold was implemented by an amendment of 22 July 2020. In this respect, there is a specific and accelerated review procedure (see Section V). While the change was originally intended to apply until 31 December 2020, it was extended until 31 December 2022 by a decree dated 22 December 2021 and then until 31 December 2023 by a decree dated 23 December 2022. On 5 January 2023, the French Minister of the Economy announced that the temporary 10 per cent threshold into listed companies will become permanent.

Strategic sectors

Under the FFIR, the authorisation procedure applies to investments in a French company whose activities fall within at least one of the strategic sectors covered by Article R151-3 of the MFC. The list of strategic sectors has been significantly expanded over the past years. These strategic sectors include the following activities:

- activities likely to jeopardise national defence interests in the exercise of a public authority or likely to jeopardise public order and public safety, including activities relating to national defence equipment and sensitive data (this first list has no materiality threshold: even a very small activity falling within this list will trigger a filing);
- activities likely to jeopardise national defence interests in the exercise of a public authority or likely to jeopardise public order and public safety when they concern essential infrastructure, goods or services, including to ensure the functioning of supply of energy sources, transport networks, water and food; and
- activities likely to jeopardise national defence interests in the exercise of a public authority or likely to jeopardise public order and public safety when they are intended to operate in one of the activities mentioned in point (a) or point (b), above, including research and development activities, which now include biotechnology activities (following the 2020 amendments to the FFIR) and technologies involved in the production of renewable energy (following the 2021 amendments to the FFIR).

iv Voluntary screening

French foreign investment screening is mandatory and suspensory. A transaction falling within the scope of the FFIR must be notified to the MOE and cannot be concluded until clearance has been obtained.

v Procedures

Review procedures

Under the FFIR, there are two review phases. The MOE has 30 working days from submission of the complete notification to perform the following:

- clear the transaction without condition;
- declare that the transaction falls outside the scope of the FFIR; or
- open an in-depth review of the transaction.

If the MOE decides to open an in-depth review, it has 45 additional working days to clear the transaction with or without conditions or to prohibit the transaction.

This means that under the new regime the review process can take between one and a half and five months.

Furthermore, a specific and accelerated procedure exists in the above-mentioned case of a minor investment in a listed sensitive company exceeding 10 per cent of the voting rights. At first, the parties must submit a preliminary and simplified notification of the investment to the Treasury, which will decide within 10 days (and not 30 days) to allow it or, alternatively, to have the parties revert to the normal procedure because of sensitivity concerns. In that case, the parties must complete a formal authorisation request under the traditional filing requirements of the normal 75-day time-frame procedure.[3]

Preliminary rescript procedure (possibility to request an opinion)

In 2018, it was possible, prior to any formal foreign investment filing, for a French target to ask the MOE whether its activities fell within the scope of the FFIR. However, the mandatory requirement of a specifically identified investment, as well as frequent unsuccessful outcomes (resulting in wasted time), made this rescript tool difficult to use in practice and therefore not as appealing from the perspective of the parties.

As of 1 April 2020, these limitations have been largely eliminated, as a French entity may ask the MOE at any time whether all or part of its activity falls within the scope of the FFIR provisions, without having to specify the identity of the potential new investor. However, the entity must still be able to justify its request with an investment project proposal.

After such a request, the MOE is required to respond within two months.

Appeal procedures

The decisions of the MOE may be appealed before an administrative judge. From a procedural standpoint, undertakings have to demonstrate that the MOE made an obvious mistake when making its assessment, which is a difficult criterion to fulfil.

In any case, undertakings rarely make use of this ability because of the sensitive and casuistic nature of this type of administrative decision, and there is some reluctance from administrative courts to go proactively against the administration. As a result, the MOE has been successful in the rare cases challenging its decisions.

vi Prohibition and mitigation

The MOE reviewed 325 of the 1,725 new foreign investments made in 2022, compared with 328 reviews in 2021, 275 reviews in 2020, 216 reviews in 2019 and 184 reviews in 2018. There is thus a 76 per cent increase of reviews between 2018 and 2022. This upward trend over the past few years may illustrate the government's increasingly broad and flexible review powers targeted at protecting national interests.

Foreign investment decisions are not publicly available in France, except for high-profile cases that may be leaked in the press.

In practice, most of the reviewed transactions are authorised. Depending on the level of sensitivity of the activities, commitments may be imposed, in particular, to ensure the continuity and the security of sensitive activities subject to review or to safeguard the know-how of the French entity. In 2022, 53 per cent of the MOE's authorisation decisions were issued with commitments.

While prohibition cases in France have remained rare to date, the end of 2020 and early 2021 saw the MOE formally prohibit one transaction and informally express its disapproval with respect to two other transactions under the strengthened and expanded FIRR. The MOE prohibited the acquisition of military solutions pioneer Photonis by US defence manufacturer Teledyne. In December 2020, it ended a tumultuous saga after almost a year of negotiations between the government and the US conglomerate. Initially, the government was focused on designing a package of commitments for Teledyne that would protect France's strategic interests while at the same time preserving its economic attractiveness. By the end of 2020, Teledyne had finally agreed to a set of stringent conditions, notably granting a minority shareholding interest and veto rights to the French public investment bank Bpifrance. However, the government made a U-turn at the last minute, through its defence minister, concluding that Photonis's activities were too strategic to be managed by a non-French participant, irrespective of any potential commitments. Photonis was subsequently acquired by HLD, the French investment group, for €370 million – much less than the €500 million that Teledyne was initially offering.

In January 2021, the proposed acquisition of French leading retailer Carrefour by Canadian convenience store chain Couche-Tard was nipped in the bud by Minister Bruno Le Maire. In a matter of days, he sent a 'courteous, clear and definitive no' to the Canadian group before any formal notification on the investor's side. In considering that the proposed transaction between two food retail groups involved a strategic sector (on the basis that it would have an impact on France's food security), the government showed its willingness to adopt a broad interpretation of its ever-growing list of strategic sectors.

Similarly, in April 2021, CNH Industrial, the parent company of Iveco, announced that it had ended discussions with China's FAW Group over the sale of a unit of Iveco SpA comprising the Iveco, Iveco Bus and Heuliez Bus brands. The decision was welcomed by both France and Italy, with CNH announcing that it would instead aim to spin off its trucks, coaches and commercial vehicles businesses by the following year. France's Minister of the Economy, Finance and Recovery tweeted that the announcement was good news because the proposed takeover raised important issues of industrial sovereignty, highlighting that France and Italy had worked hand in hand to maintain industrial capacity in Europe.

At the beginning of 2023, the acquisition of Exxelia International (a key supplier to the French defence industry) by the American company Heico Corp created controversy in the political field. According to the French press, although the transaction was authorised by the MOE, the MOE assured that the French state would have 'a real power of control over the new owner'.

During the same period, according to public information, the French Ministry of the Armed Forces would have opposed the acquisition of Segault (a French company that notably supplies valves for the on-board nuclear boiler rooms of French nuclear submarines) by the American company Flowserve. According to public information, the veto of the French Ministry of the Armed Forces would have led to the veto of the MOE, though we have no clear confirmation that the operation has been prohibited.

These cases illustrate the government's clear commitment towards favouring the protection of national interests over economic attractiveness to ensure that France's national interests remain safeguarded.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

There are no sector-specific requirements.

ii Restricted sectors

There are no sector-specific requirements.

V TYPICAL TRANSACTIONAL STRUCTURES

Regardless of the type of transaction (asset or share) or transactional structure, foreign entities should keep in mind that a single non-French entity or a non-French acquisition vehicle in the 'control chain' of an acquirer would be sufficient for the acquirer to be regarded as a foreign investor subject to the review of the MOE. Furthermore, the acquirer would be subject to even stricter thresholds with regard to non-controlling minority investments if that entity was non-European.

Indeed, further to the French reform, all persons and entities that belong to a control chain are investors. Therefore, any (European or non-European) entity that comes into the control chain may be considered a foreign investor.

The notion of control of a company that has its registered office in France is different from the concept of control under competition law and is very broadly defined by Article L233-3 of the Commercial Code, as discussed in Section I.iii.

VI OTHER STRATEGIC CONSIDERATIONS

Merger control approvals and foreign investment reviews now seem to go hand in hand when assessing whether and where a transaction should be notified. Even though the scope of the review by the authorities differs and both reviews are conducted independently from one another, a certain convergence of the two regimes can be seen, with both regimes sometimes seeming to take a more political approach.

VII OUTLOOK

From a practical perspective, future foreign investors will have to face a government that has increasingly broad and flexible review powers targeted at protecting the French national interest.

The MOE is treading a thin line, however, because its protectionist intent must not discourage foreign entities from investing in France or be seen to be inhibiting economic growth. The increasing number of notifications, coupled with MOE participation in the EU cooperation mechanism, may have the unintended effect of slowing down its Phase I review period.

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Endnotes

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2 EY Attractiveness of France Barometer 2023, Episode 1, available at: https://assets.ey.com/content/dam/ey-sites/ey-com/fr_fr/topics/attractiveness/barometre-de-l-attractivite-de-la-france-2023/ey-barometre-attractivite-france-2023-episode-1-20230525.pdf.

3 Article R151-5 of the Monetary and Financial Code.

Chapter 10

Germany

Frank Röhling and Uwe Salaschek[1]

Summary

I OVERVIEW

German law provides for a comprehensive review of foreign direct investment (FDI). The investment control regime is primarily regulated by the Foreign Trade and Payments Act (AWG) and the Foreign Trade and Payments Ordinance (AWV). Both provide the German Ministry for Economic Affairs and Climate Action (BMWK) with broad powers to review FDI and to take remedial action on grounds of public order or public security (in relation to Germany, other EU Member States or projects of EU interest) or on grounds of essential security interests (in relation to Germany only). Under German law, FDI may trigger mandatory filings or be subject to *ex officio* screening.

Notifications are mandatory for investments in (1) companies engaged in defence activities or similarly sensitive security areas (the 'sector-specific' regime) and (2) companies engaged in activities in certain other business areas that the BMWK considers sensitive. Among other activities, this covers critical infrastructure and critical technology (the 'cross-sectoral' regime). Filings are triggered if certain voting right thresholds are met (10, 20, 25, 40, 50 and 75 per cent). Mandatory filings must be submitted to the BMWK without undue delay after signing. Failure to obtain clearance prior to closing may constitute a criminal offence with fines or imprisonment of up to five years.

In addition to the mandatory review, the BMWK may review any foreign investment in a German entity equal to or exceeding 25 per cent. Submitting a voluntary filing considerably shortens the period within which the BMWK can review the transaction (otherwise five years from signing).

Regulatory scrutiny of FDI in Germany has increased steadily over the past few years. Among the most recent developments have been the extension of the scope of application to more companies in the health sector; the lowering of the substantive standard for screening in response to the EU FDI Screening Regulation,[2] to include 'likely effects' on public order or security; and, most recently, in 2021, the inclusion of a large number of new sectors and technologies triggering mandatory reviews. While the various expansions have led to an increasing number of notifications, only a few transactions have been blocked, aborted or amended because clearance could not be obtained (most notably concerning wafers, semiconductors, ventilators and a container terminal). In addition, over the past four years, the number of cases in which potential concerns were mitigated has dropped and the vast majority do not require mitigation and are cleared relatively quickly.

II YEAR IN REVIEW

In terms of the BMWK's review practice during 2022, it examined 306 cases and imposed restricting measures in seven cases.[3] Among those, the proposed acquisitions of a container terminal in Hamburg, Elmos, Heyer and Siltronic are considered landmark cases.

In October 2022, approximately one year after the notification, the BMWK issued a partial prohibition against the acquisition of a stake in one of Hamburg's container terminals by the Chinese state-owned shipping and logistics company Cosco. Instead of the originally intended 35 per cent participation, the BMWK approved only the acquisition of a minority interest of 24.99 per cent and also prohibited the acquisition of any other rights that would give Cosco greater influence. The partial prohibition received an unprecedented level of publicity due to the controversial views within the German government. Six ministries and at least two German intelligence agencies voiced their opposition to the deal. Also, the European Commission and other governments expressed reservations. However, German chancellor Olaf Scholz backed the transaction and stressed the importance of strong trade between China and Germany. A few months after the transaction was partially prohibited, the government realised that, at the time of the decision and in contrast to the government's original assessment, the container terminal constituted critical infrastructure under German law. Nonetheless, no further action was taken and the transaction was closed.

Shortly after this decision, the BMWK prohibited the indirect acquisition of a chip factory of semiconductor manufacturer Elmos by a Chinese (state-owned) company. The BMWK also considered prohibiting the acquisition of ERS Electronic, another German semiconductor company, by an unknown Chinese investor,[4] but the application was withdrawn before the prohibition was authorised.

In relation to Elmos, the BMWK issued a press release in which the Federal Minister for Economic Affairs and Climate Action emphasised that Germany's technological and economic sovereignty was of great importance, especially in the semiconductor sector, and that mitigation measures were therefore not suitable to remedy the identified concerns.[5]

In early 2022, the BMWK retroactively prohibited the acquisition of medical device manufacturer Heyer by a Chinese acquirer. Respiratory equipment such as the ventilators manufactured by Heyer were of considerable importance during the covid-19 pandemic. In light of this, the BMWK argued that Germany's independence from non-European manufacturers of respiratory equipment was of utmost importance.[6] While the goal of maintaining security of supply is understandable, public information suggests that Heyer neither was an important supplier (*de minimis* sales following insolvency proceedings) nor owned know-how on special or new technologies. There also appeared to be various alternative European suppliers.

Against this backdrop, investors from China must continue to carefully review FDI filing obligations and clearance prospects when investing in sensitive targets.

As regards the proposed acquisition of German wafer manufacturer Siltronic by a Taiwanese chip manufacturer, the BMWK did not issue a certificate of non-objection in time for the transaction to close within the long-stop date. Shortly before this date, the parties agreed on far-reaching remedies with the Chinese competition regulator, including a most favoured nation clause for Chinese customers. While its review had been ongoing for over a year at the time, the BMWK claimed that the Chinese remedies might have had a significant impact on German customers that it did not have time to assess properly. The purchaser unsuccessfully sought immediate relief from the Berlin Administrative Court. An appeal against this decision was subsequently rejected by the Higher Administrative Court of Berlin-Brandenburg.[7]

In terms of legislation, the past year (since June 2022) has brought no changes to Germany's FDI rules, but there has been one change in a different legal instrument that has an impact on foreign investment. An amendment of the legislative order broadening the definition of critical infrastructures (BSI-KritisV)[8] entered into force on 2 March 2023. More specifically, liquefied natural gas terminals as well as cable landing points for submarine telecommunications cables are now also considered critical infrastructure in the energy and information technology (IT) and telecommunications sectors. This amendment is a reaction to the attacks on the Nord Stream gas pipelines and, among other things, leads to an obligation on operators to report attempted attacks or operation disruptions.[9] However, as mentioned above, the acquisition of critical infrastructure as defined in the BSI-KritisV can trigger mandatory filing obligations. Thus, the amendment also has an indirect impact on whether investments are notifiable.

III FOREIGN INVESTMENT REGIME

i Policy

The German government has increased scrutiny against foreign investments in recent years, particularly regarding investments with a nexus to China (as is illustrated by the cases mentioned above, as well as by a leaked draft of the strategy paper 'Internal Guidelines on China' by the BMWK).

The BMWK employs two different legal tests for the cross-sectoral and the sector-specific regimes. Under the former, the BMWK tests whether an investment 'is likely to affect public order or security in Germany, another EU Member State or projects of EU interest'. Under the latter, the BMWK tests whether an investment is 'likely to affect Germany's essential security interests'.

The likely-to-affect standard is an example of the German legislature's heightened scrutiny of foreign investments. The relatively new standard, introduced in 2020 for the cross-sectoral review and extended to the sector-specific review in 2021, lowers the BMWK's threshold for intervention in foreign investments in Germany and replaces the previous standard, under which an investment had to pose an 'actual risk' for public order or security to risk prohibition. It is unclear whether this test is compliant with EU law, as national measures restricting FDI must address a genuine and sufficiently serious threat to an overriding public interest in order to be justified in view of the applicable fundamental freedoms, as has been recently reinforced by the Court of Justice of the European Union.[10]

To determine whether an investment raises substantive concerns under the likely-to-affect standard, two points are decisive: first, the identity of the investor (investor risk) and, second, the target's activities (target risk).

Regarding the investor's identity, under Sections 55a(3) and 60(1b) of the AWV, the BMWK may take into account (1) whether the investor is directly or indirectly controlled by the government of a third country, (2) whether the investor has previously been involved in activities detrimental to German public order or security and (3) whether there is a serious risk that the investor has been or is engaged in criminal activities. In addition, the investor's country of origin, its institutional set-up (e.g., strategic versus financial) and its intended future engagement with the target's activities are considered. Also, the likelihood of (potentially) sensitive technologies ending up in non-allied countries such as China or Russia may be taken into account. Separately, the BMWK is averse to German technology falling within the scope of third countries' export control rules as a result of a transaction and the possibility of subsequent relocation of production, in particular 'ITAR infections' (i.e., the extension of the US International Traffic in Arms Regulations to products previously not subject to these rules).

Several factors are to be considered in relation to the target's activities, such as whether the target has access to classified or confidential information or disposes of sensitive data, technologies, know-how or patents; whether customers include the government, public agencies or the armed forces; and whether the target is an indispensable supplier or is important in maintaining security of supply in Germany, or whether there are alternative suppliers.

ii Laws and regulations

As described above, the investment control regime is primarily regulated in the AWG and the AWV, but the list of sectors triggering review also refers to other statutes. Therefore, further regulations must be considered in the review. The BSI-KritisV[11] is important in this respect because it contains certain thresholds for a variety of sectors. If an entity's activity in a certain sector exceeds these thresholds, it is considered critical and its acquisition is subject to mandatory review. Similarly, the German Export List (relating to military items) or the EU Dual Use Regulation may have to be considered when reviewing foreign investments.

Formal requirements for information and documents to be included in (mandatory and voluntary) notifications are set out in the BMWK's directive of 27 May 2021 published in the German Federal Gazette.[12]

iii Scope

The BMWK's scope of review depends on (1) the investor's nationality and (2) the sector in which the German target business is active.

Generally, investments by a non-EU or non-European Free Trade Association (EFTA) investor equal to or exceeding 25 per cent or more of the voting rights (depending on the sector) in any German target are subject to review. Whether an investor qualifies as German, EU or EFTA depends on its place of incorporation and management,[13] but the BMWK looks not only at the direct investor but also at the ultimate parent entity and every other entity along the corporate chain. Only investments in defined sensitive business sectors trigger a mandatory filing (under either the cross-sectoral or the sector-specific regime – see below for details).

Following recent expansions of the scope of both the cross-sectoral and the sector-specific review, both tests may apply in certain transactions. The BMWK can switch between both regimes even after commencing the in-depth review. This means that the substantive test used by the BMWK in its review changes. But, otherwise, the process simply continues (i.e., all information provided up to that point can be used in the amended review, and statutory timelines continue rather than beginning again).

Mandatory notifications under the cross-sectoral regime

Under the cross-sectoral review, a notification to the BMWK is mandatory only if the German target (including the German subsidiary of a foreign target) operates in certain sensitive sectors and the applicable 10 or 20 per cent threshold is met. Unless specifically mentioned, there are no *de minimis* exemptions. This means that even very limited activities in a sensitive sector may trigger filing obligations, and this also applies where a target's sensitive activities represent only a very small share of the target's overall activities.

The acquisition of 10 per cent or more of the voting rights in a German target (including the German activities of a foreign target) by a non-EU or non-EFTA investor triggers a mandatory filing if the German company is active in any of the sectors set out in Section 55a(1) No. 1-7 of the AWV, specifically where the target:

- operates critical infrastructure under the Act on the Federal Office for Information Security (BSIG)[14] (i.e., infrastructures in the energy, water, IT and telecommunications, finance and insurance, health, transport and traffic or nutrition sectors) or delivers cloud computing services and exceeds certain thresholds, as defined in the BSI-KritisV;
- specifically develops or modifies industry-specific software that serves the operation of critical infrastructures under the BSIG;
- is entrusted with organisational tasks under Section 110 of the Telecommunications Act for the operation of a telecommunications system that provides publicly available telecommunications services or produces technical facilities for implementing legally prescribed measures for monitoring telecommunications (or has produced such facilities and maintains knowledge of the underlying technology);
- holds permission for components or services for the telematics infrastructure under Section 325 or Section 311 Subsection 6 of the Fifth Book of the German Social Code;
- is active in the media industry and contributes to public opinion through broadcasting, telemedia or print products and is characterised by particular topicality and has a broad impact; or
- delivers services that are necessary to ensure the effectiveness and functioning of state communication infrastructures within the meaning of Section 2(1), sentences 1 and 2 of the Act on the Establishment of a Federal Authority for Digital Radio for Authorities and Organisations with Security Tasks.

The acquisition of 20 per cent or more of the voting rights in a German target (including the German activities of a foreign target) by a non-EU or non-EFTA investor triggers a mandatory filing if the target is active in the following sectors pursuant to Section 55a(1) No. 8-27 of the AWV, specifically where the target:

- designs or manufactures personal protective equipment within the meaning of Article 3(1) of Regulation (EU) 2016/425;

- develops, manufactures or markets medicinal products essential for ensuring the provision of healthcare to the population, including their starting materials and active substances, or is the holder of a corresponding marketing authorisation under pharmaceutical law;
- develops or manufactures medical devices intended for the diagnosis, prevention, monitoring, prediction, prognosis, treatment or alleviation of life-threatening and highly contagious infectious diseases;
- develops or manufactures in vitro diagnostic medical devices used to provide information on physiological or pathological processes or conditions or to determine or monitor therapeutic measures in connection with life-threatening and highly contagious infectious diseases;
- operates a high-quality remote earth observation system;
- develops or manufactures goods with artificial intelligence that may be used for cyber-attacks, to spread targeted disinformation, to enable internal repression or for the purpose of surveillance;
- develops or manufactures autonomously navigating motor vehicles or unmanned aerial vehicles or essential components thereof;
- develops or manufactures robots that are specially designed to handle highly explosive substances, to withstand high radiation doses, to operate at altitudes above 30,000 metres or to operate in water below 200 metres;
- develops, manufactures or processes semiconductor circuits, micro or nano structured optical circuits, or manufacturing or processing tools to manufacture the aforementioned goods;
- develops or manufactures certain IT products (or components thereof) essential to the integrity of IT systems or defence against attacks on such systems or that support criminal investigations by law enforcement agencies;
- operates an air carrier with an operating licence pursuant to Regulation (EU) No. 1008/2008 or develops or manufactures certain goods listed in Annex I to Regulation (EC) No. 428/2009 or goods used in space infrastructure systems;
- develops, manufactures, modifies or uses certain dual-use items;
- develops or manufactures goods based on or relating to quantum physics;
- develops or manufactures goods specifically designed for the operation of wireless or wireline data networks;
- manufactures smart meter gateways and related goods;
- employs individuals working in 'vital facilities';
- mines, processes or refines certain raw materials or their ores as defined by the European Commission's 'raw materials initiative';
- develops or manufactures goods based on classified patents or classified utility models; or
- directly or indirectly cultivates an agricultural area of more than 10,000 hectares.

Mandatory notifications under the sector-specific regime

Any investment of 10 per cent or more of voting rights by non-German investors in a German target (including the German activities of a foreign target) active in the following sectors listed in Section 60(1) of the AWV triggers a mandatory filing, specifically where the target:

- develops, manufactures, modifies or actually possesses goods within the meaning of Part I Section A of the Export List;
- develops, manufactures, modifies or actually possesses defence technology goods covered by a patent rendered secret pursuant to Section 50 of the Patent Act or a utility model rendered secret pursuant to Section 9 of the Utility Models Act;
- manufactures or has manufactured products with IT security functions for processing classified state material or components essential to the IT security function of such products and still possesses the underlying technology and the company's products or, in the case of essential components for the IT security function, the overall product has been licensed by the Federal Office for Information Security; or

- qualifies as a facility that is vital to defence within the meaning of Section 1 Subsection 5 sentence 2 No. 1 of the Security Clearance Check Act.

Calculation of voting rights

The acquisition of voting rights equal to or exceeding the applicable 10, 20, 25, 40, 50 or 75 per cent threshold (depending on the activities of the German target and the number of the purchaser's voting rights held prior to the transaction) leads to the applicability of the German FDI regime regardless of the type of acquisition (e.g., share or asset deal or a transaction structure such as a merger, swap transaction or capital increase). For assets to meet the test, they must constitute either a 'definable part' of the target's business operations or 'all the essential operating equipment' of the target.[15] However, according to the BMWK, even the acquisition of stand-alone intellectual property rights may constitute an acquisition of assets. There is no *de minimis* exemption (i.e., no transaction value or revenue threshold below which investments are exempted from review.)

German FDI rules apply to both direct and indirect acquisition of voting rights. In indirect acquisitions where voting rights are held by two or more entities in the investor's holding structure, voting rights held by a subsidiary are attributed to the investor if both the subsidiary holding the voting rights and the investor (or one of its (direct or indirect) subsidiaries) have voting rights of 10, 20 or 25 per cent in their respective subsidiaries.[16] In addition, pursuant to Section 56(4) of the AVW, voting rights of third parties are attributed to the investor where the investor and a third party concluded a vote pooling agreement or, as a matter of fact, they are expected to exercise their voting rights jointly (this includes the assumption that voting rights held by state-owned entities from the same state are added together).

Based on the above, the transaction structure must be closely examined for an FDI review. For example, the acquisition of a non-German, non-EU or non-EFTA target having an interest equal to or exceeding 10, 20 or 25 per cent in a German company (depending on the activities of the German target) may trigger a mandatory review. Similarly, an EU company in which a non-EU shareholder has voting rights of 10, 20 or 25 per cent or more (depending on the activities of the German target) acquiring an interest equal to or exceeding 10, 20 or 25 per cent in a German target (depending on the target's activities) may also trigger a review. It is important to emphasise that a review is triggered through the acquisition of voting rights alone (i.e., unlike under merger control law, there is no requirement for the investor to acquire economic shares or control).

In addition, a review (but not a filing obligation) may be triggered by the acquisition of 'atypical control' over a German target.[17] Atypical control is assumed if, in addition to the acquisition of voting rights, the acquirer also obtains:

- seats in supervisory bodies or in management that are disproportionate to the investor's shareholding or voting rights;
- veto rights in strategic business or personnel decisions; or
- certain information rights.

iv Voluntary screening

Under certain circumstances, a voluntary application for a certificate of non-objection might be advisable in cases where a notification is not mandatory. As set out above, the BMWK has the power to review any investment by a non-EU or non-EFTA investor (or by an EU or EFTA investor in which a non-EU or non-EFTA investor holds a relevant interest) equal to or exceeding 25 per cent of voting rights in the German target (regardless of the sector involved). The BMWK may exercise its right to review for up to five years after signing.[18] This poses a significant risk to transaction security, particularly as the review may, in a worst-case scenario, even lead to a (retroactive) prohibition of the transaction (which would have to be unwound) or the imposition of conditions.

To mitigate this risk, it may be advisable to voluntarily apply for a certificate of non-objection. The application triggers a two-month review period within which the BMWK must decide whether an in-depth review is warranted.[19] In considering whether or not to apply for a certificate of non-objection, investors may consider:

- the investor's identity or nationality;
- how closely related the German target's activities are to sensitive sectors mentioned in Sections 55a and 60 of the AWV;
- the option to explain the transaction (and its non-sensitivity) to the BMWK; this may be particularly helpful where extended press coverage or third-party complaints are expected;
- the existence of supply contracts with federal, state or municipal entities, in particular the armed forces, police or intelligence services;
- obligations to notify the same transaction with other EU Member States' FDI or merger control authorities; or
- exposure of the target's business activities to any political or strategic interests of Germany or the EU.

v Procedures

Ex officio review and review upon notification

The BMWK may initiate an *ex officio* review or review the investment upon notification. In *ex officio* proceedings, after obtaining knowledge of the transaction, the BMWK has two months to inform the direct acquirer and the domestic target company that it intends to initiate an in-depth review, which adds four months to the review timeline.[20] In practice, it is difficult to determine when the two-month period commences (and expires) unless the parties actively inform the BMWK. In any event, the BMWK's power to initiate an *ex officio* review expires five years after signing. If a filing is mandatory, the direct acquirer is obliged to submit a filing to the BMWK without undue delay after signing. Filings may also be made before signing if the transaction is sufficiently certain. The two-month (Phase I) review period starts on the day of submission of the (complete) filing. If the BMWK does not commence an in-depth review in Phase I, clearance is deemed to be granted.[21]

The BMWK's decision to open a Phase II review is typically accompanied by a request for further information. Part of this information is listed in an administrative directive.[22] In addition, the BMWK typically requires further transaction-specific information. The four-month Phase II review timeline begins only once all information has been received by the BMWK. The BMWK may extend this period by another three months if the assessment reveals particular 'actual or legal difficulties' and by one additional month if the transaction affects defence interests. A stop-the-clock mechanism applies if the BMWK requests additional information or if conditions are being negotiated.[23] Taking all this together, the timeline for a Phase II review can range from a couple of months to over a year.

Notification formalities

Mandatory and voluntary notifications require certain mandatory information about the target, the transaction structure, the investor (including the entity directly acquiring the German target) and the seller.[24] Information and documents to be provided include:

- a power of attorney;
- information on the German target entity;
- details of the acquisition;
- information on the direct acquirer and indirect acquirer; and
- information on the direct seller.

Since April 2023, the notification must include four Excel forms (containing information on (1) the transaction, (2) the target, (3) the acquirer and (4) the seller; available on the website of the BMWK)[25] and must be submitted to the BMWK electronically (i.e., by email).[26] Unlike in other EU Member States, the BMWK does not require investors to submit the EU form with the original filing. Instead, the form is required only if the BMWK initiates an in-depth (Phase II) review.

Decisions

The BMWK has two months to conduct the initial Phase I review and initiate the in-depth Phase II review. If the two months elapse without any decision, the investment is deemed cleared by the BMWK (tacit clearance).

As well as clearing or prohibiting a transaction, the BMWK may impose restrictive measures (e.g., prohibiting the investor from exercising voting rights). During the in-depth review, the BMWK may also negotiate agreements with the parties to mitigate potential public order or security concerns. The ensuing clearance decision will make reference (and be conditional upon) these security agreements. Alternatively, the BMWK may grant clearance only subject to fulfilment of certain instructions (i.e., imposed rather than negotiated conditions).

From a civil law perspective, the contract underlying the transaction is rendered void (in relation to the German activities) if the BMWK prohibits an investment.

Judicial relief

The parties to the transaction may seek judicial relief against the BMWK's decisions. Proceedings follow the general rules of the German Code of Administrative Court Procedure, under which the Berlin Administrative Court has jurisdiction for legal actions against the BMWK's decision. Legal actions do not have a suspensory effect. This means that the parties are bound by the BMWK's decision until the Court reverses it. Legal actions against BMWK prohibitions are currently rare but expected to become more common as the number of prohibitions increases.

Standstill obligation and gun-jumping

If filing a notification to the BMWK is mandatory, parties are prohibited by law from implementing (certain parts of) the investment (a standstill obligation). Premature closing (known as gun-jumping) constitutes a criminal offence with severe fines or even imprisonment pursuant to Section 18(1b) and Section 19(1) No. 2 of the AWG. For the investor, this means that neither voting rights nor economic rights can be exercised.

For the seller and target company, this means that certain sensitive information may not be shared with the investor. Prior to signing, it may be prohibited to exchange information that is subject to non-disclosure agreements or classified under German law. Once the transaction is signed, the exchange of any information relating to public order or security interests is prohibited as this triggers a filing obligation.[27] Determining such information requires a case-by-case analysis considering both the German target's activities and the technological know-how it owns. On the one hand, publicly available information such as information from the patent register, purely commercial information or public permits are not sensitive. On the other hand, information such as technological know-how, access information for IT systems, technical drawings or plans, personal user data and classified information will often be considered sensitive. In cases of doubt, the parties are well advised to discuss the issue with the BMWK to avoid sanctions.

vi Prohibition and mitigation

Of the total of 306 filings to the BMWK in 2022, 262 were filed under the cross-sectoral regime and 44 under the sector-specific regime.[28] The BMWK does not publish specific data on the number of transactions it has prohibited. Publicly available information suggests that in approximately five to 10 cases transactions were either prohibited or abandoned by the parties for lack of German FDI clearance.

IV SECTOR-SPECIFIC REQUIREMENTS

There are no sectors in which foreign investments are prohibited per se. The BMWK has sole authority to review FDI. Prohibitions must be authorised by the German government.

V TYPICAL TRANSACTIONAL STRUCTURES

Depending on the exact structure of a transaction, the German FDI analysis can be quite complex, especially where more than two parties are involved or where the target's activities are sensitive. Even the acquisition of a non-German target that holds voting rights equal to or exceeding 10, 20 or 25 per cent in a German target may be reviewable. Similarly, an EU-domiciled acquirer's investment in a German target is reviewable if a non-EU or non-EFTA shareholder holds voting rights equal to or exceeding 10, 20 or 25 per cent in the acquirer. Apart from lowering the level of voting rights to be acquired, there is very little an investor can do to avoid FDI review. For example, greenfield investments, such as setting up new production facilities, are not covered by the German regime.[29]

Even internal reorganisations can trigger filing obligations and there is only a very narrow exemption: Section 55(1b) exempts internal reorganisations only if the German entity's ultimate parent entity remains the same and no (direct, indirect or intermediate) shareholder from a new jurisdiction enters the holding structure. Furthermore, as narrow as this exemption is, it also applies only to the cross-sectoral review and not to internal reorganisations that would trigger a sector-specific review.

Private equity fund structures may also raise particular issues. Typically, funds are structured as limited partnerships, where the general partner exercises 100 per cent of the voting rights and the limited partners do not exercise any voting rights. In practice, it is sufficient to disclose the identity of the general partner for the purposes of the FDI review. However, the BMWK may request additional information on the identity of any limited partner during the process.

It is advisable to consider potential German FDI implications at an early stage of the transaction and, at the latest, when drafting transaction documents. If filing is mandatory, closing should be conditional upon FDI clearance by the BMWK. Parties may also consider allocating the regulatory risk of obtaining German FDI clearance in the transaction documents. Lastly, parties should have in mind the potentially lengthy and sometimes unpredictable review periods when setting long-stop dates.

VI OTHER STRATEGIC CONSIDERATIONS

The BMWK actively participates in the European cooperation mechanism set up by the EU FDI Screening Regulation. The cooperation mechanism facilitates the exchange of information between Member States. Parties should be aware of the increased transparency between Member State FDI regulators, particularly in cases involving filings in various Member States.

Investments in German targets may also trigger merger control filing obligations. However, investments subject to FDI review do not automatically require merger control clearance, and vice versa. If a merger control filing is required, procedures are, as a general rule, independent and follow a different set of rules and timelines. The Federal Cartel Office (FCO) is an independent authority, but it reports to the BMWK. Parties filing a merger control notification with the FCO should therefore assume that the BMWK will become aware of the FCO notification and, as such, of the transaction.

Although the review standards deployed for merger control and investment screening differ significantly, there are a couple of points of overlap: first, in some of its recent cases, the FCO explored whether state-owned enterprises are particularly likely to employ predatory pricing strategies and it considered, for example, national industrial strategies and state subsidies as well as previous predatory or exclusionary behaviour by the states concerned.[30] This is similar to what the BMWK has done in at least one review (of a Chinese state-owned acquirer). Second, whereas market entry by foreign companies may be seen favourably for the purposes of merger control review, potential entries from certain states (e.g., China) may be viewed critically in an FDI review. Lastly, both merger control and FDI authorities may consider the extent to which a company is indispensable to the supply of certain goods or services.

VII OUTLOOK

The review of foreign investments remains an area of increasing regulatory scrutiny in Germany. Not only is the German regime in line with a discernible international trend, it can also be considered one of the forerunners. Following many legislative actions and amendments in recent years, the BMWK is considering combining the various rules on FDI that are currently spread out over the law on foreign trade and an ordinance on foreign trade into one new law on FDI review. While it will likely take some time for this change to take shape, the BMWK will likely introduce a filing fee for FDI filings in the shorter term. In addition, the war in Ukraine, sanctions against Russia and Belarus, potential energy shortages and a shift in political alliance may well trigger further legislative developments.

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Endnotes

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11 An order based on the Act on the Federal Office for Information Security.
12 See BMWK, General Directive of 27 May 2021 on the required documentation under Section 14a AWG and Sections 55a, 58 and 60 AWV, BAnz AT 11 June 2021 B2.
13 See Section 2(15), (18) and (19) AWG.
14 Critical infrastructures are organisations or facilities with important significance for the community whose failure or impairment would result in lasting supply bottlenecks, significant disruptions to public safety or other dramatic consequences.
15 Section 55a(1a) and Section 60(1a) AWV.
16 See Section 56(4) and 56(5) AWV.
17 Section 56(3) AWV.
18 Section 14a(3) AWG.
19 Section 14a(1) No. 1 AWG.
20 Section 55(3) AWV, Section 14a(1) No. 1 AWG.
21 Section 58(2) AWV.
22 See BMWK, General Directive of 27 May 2021 on the required documentation under Section 14a AWG and Sections 55a, 58 and 60 AWV, BAnz AT 11 June 2021 B2.
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Chapter 11

India

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Summary

I OVERVIEW

Since the liberalisation policy of 1991, India has emerged as one of the most favoured destinations for foreign direct investment (FDI). Despite high inflation, global recessionary fears and the supply chain disruptions caused by the Russia–Ukraine war and the covid-19 pandemic, India has emerged as an investment hotspot, with numerous investment opportunities. The Indian economy has grown to become the fifth largest economy in the world, with its gross domestic product (GDP) reaching US$3.75 trillion (from about US$2 trillion in 2014, when the Indian economy was the tenth largest in the world). FDI flows to India have increased by about 10 per cent in 2022 according to the World Investment Report 2023 by the United Nations Conference on Trade and Development,[2] with India being the third largest host country for greenfield projects announcements and stably registering the eighth position in terms of FDI inflows globally. The International Monetary Fund, in its World Economic Outlook Report (April 2023), projected India to be the fastest-growing economy in the world,[3] as is also projected by the World Bank.[4] In April 2023, the United Nations reported India as the most populous country in the world, and it is expected to add 97 million individuals to its working force over the next decade, representing the largest workforce growth during this period.

The Indian government has introduced several initiatives and policies to encourage FDI in India and to enable increased ease of doing business in India. These include the National Logistics Policy 2022 (NLP) (which will operate in tandem with the GatiShakti National Master Plan).[5] India has also entered into an economic cooperation and trade agreement with Australia[6] and a comprehensive economic partnership agreement with the United Arab Emirates.[7] In furtherance of tapping foreign investments in India and transforming India into a global manufacturing hub, the Indian government has introduced policies such as 'Make in India', Atmanirbhar Bharat and production linked incentive (PLI) schemes, in tandem with liberalisation of FDI in various sectors. These are in continuation of the Indian government's endeavours, which have seen a remarkable improvement in India's position in ease of doing business rankings from 79th place to 63rd place in five years, according to the World Bank's Doing Business Report of 2020.[8] Further, in Global Innovation Index 2022, India has risen to the 40th rank (as against 81st in 2015).[9]

Foreign investment in India is primarily governed by:

- the Foreign Exchange Management Act, 1999 (FEMA) and the rules and regulations issued under it, such as the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (the NDI Rules);[10]
- the Consolidated Foreign Direct Investment Policy, 2020 (the FDI Policy), dated 15 October 2020, issued by the Department for Promotion of Industry and Internal Trade (DPIIT) of the Ministry of Commerce and Industry, read with the press notes issued by the DPIIT to amend the FDI Policy;[11] and
- rules issued by central government and regulations issued by the Reserve Bank of India (RBI) under FEMA (collectively known as the FDI Regulations).

The FDI Regulations provide for sector-specific conditions, including investment caps, and classify sectors into two routes: (1) the automatic route and (2) the government route. Under the automatic route, prior approval from the RBI or the concerned government department or ministry is not required for foreign investments, whereas, under the government route, prior approval from central government (in consultation with the RBI) is required for foreign investments. Apart from sectoral conditions, the FDI Regulations also provide for government approval in cases where (1) an investor is incorporated or registered in a country that shares a land border with India (i.e., China, Afghanistan, Nepal, Myanmar, Bhutan, Pakistan and Bangladesh (restricted countries)), (2) the beneficial owner of an investment into India is situated in any such restricted country, or (3) the beneficial owner of an investment into India is a citizen of any such restricted country.

During the financial year (FY) 2022–2023, the Indian government made significant progress towards its disinvestment goals and divested its stake from several public sector companies in India by employing various methods, including initial public offers and offers for sale. This included divestment of stake in the Life Insurance Corporation of India,[12] Hindustan

Aeronautics Limited,[13] Indian Railway Catering and Tourism Corporation Limited,[14] Oil and Natural Gas Corporation Limited[15] and Paradeep Phosphates Limited.[16] A number of disinvestments are also currently under way, including in Air India Airport Services Limited,[17] Air India Engineering Services Limited,[18] Rashtriya Ispat Nigam Limited,[19] NMDC Steel Limited,[20] the Shipping Corporation of India,[21] Bharat Coking Coal Limited,[22] Hindustan Zinc Limited,[23] Jammu and Kashmir Cement Limited[24] and BEML Limited.[25] Apart from the public sector undertakings, the government is also reportedly considering the divestment of a 30.48 per cent stake in IDBI Bank Limited in which various foreign investors, such as JC Flowers, Carlyle Group, Canada-based Fairfax group and Japanese Bank Sumitomo Mitsui, etc., have reportedly expressed interest.[26]

There have also been certain marquee transactions by foreign investors for distressed assets in FY 2022–2023. December 2022 witnessed the single largest non-performing asset sale in India, when JC Flowers Asset Reconstruction Company acquired non-performing assets from Yes Bank with a principal balance of approximately US$6 billion.[27]

Another notable case of distressed investment by foreign investors in India is the acquisition of Sterling Biotech Limited by a US-based pharmaceutical company Perfect Day, Inc, with the deal valued at around US$7.78 billion.[28] Further, Resurgent Power Ventures Private Limited, a private equity joint venture (JV) majority owned by global investors and constituted to acquire stressed assets, acquired South East UP Power Transmission Company Limited (an Indian entity under insolvency) in September 2022.[29] In addition, in March 2023, the National Company Law Tribunal approved a bid submitted by US-based hedge fund Silver Point Capital to acquire IVRCL Chengapalli Tollways through an insolvency process.[30]

Recent developments in the foreign investment regime

Rationalisation of reporting in single master form on FIRMS portal

The RBI, via its circular dated 4 January 2023, notified the following: (1) forms submitted on the FIRMS portal will be auto-acknowledged (the authorised dealer banks shall verify the same within five working days based on the uploaded documents, as specified); and (2) in cases of delayed reporting, the authorised dealer banks shall either advise the late submission fee to the applicants, which will be computed by the system, or advise for compounding of contravention, as the case may be.[31]

Liberalising the Indian space sector

In order to provide a favourable regulatory environment for enabling participation of private sector entities (particularly start-ups) in end-to-end activities in the space sector, the Indian government, in April 2023, rolled out the Indian Space Policy – 2023.[32] Certain key features of this policy are as follows:

- This policy allows non-governmental entities, which include companies, partnership firms, trusts and associations of persons or bodies of individuals incorporated under relevant Indian laws (non-governmental enterprises (NGEs)), to undertake end-to-end activities in the space sector through the establishment and operation of space objects, ground-based assets and related services, such as communication, remote sensing and navigation, etc.
- This policy clarifies the role of the Indian National Space Promotion and Authorisation Centre (IN-SPACe) (formed under the Department of Space of the government of India) as a single window agency for authorising and approving space activities, enabling NGEs to participate in space activities and promoting ease of doing business by formulating guidelines and procedures that will govern entities involved in space exploration.[33]

As at 1 June 2023, around 291 proposals and applications have been received by IN-SPACe for participation in categories such as satellites, launch vehicles and space applications, etc., from NGEs, including micro, small and medium-sized enterprises and start-ups.[34] To further support space start-ups, in March 2023, IN-SPACe announced an IN-SPACe seed fund scheme for innovation in India to facilitate space start-ups and provide initial financial assistance up to 10 million rupees.

IN-SPACe is currently also involved in revising the FDI policy to promote FDI in space start-ups and other NGEs, which is proposing to allow 100 per cent FDI in sub-system manufacturing and launch vehicle operations, apart from satellite operations and establishments, which is currently the only category in the space sector with 100 per cent FDI permissibility under the government approval route.[35]

National Single Window System

In furtherance of ease of doing business by providing a one-stop platform for all business approvals, the central government launched the National Single Window System (NSWS) in September 2021. NSWS is a unified digital portal for filing all business approvals across various sectors under central ministries and state governments in a hassle-free and timely manner.[36] It is a single online interface to identify, apply and track approvals and registrations. It provides a host of online services to enhance transparency and ease the approval mechanism for investors.[37] NSWS hosts applications for approvals from 31 central departments and 22 state governments.[38] Over 75,000 approvals have been granted on NSWS under various central and state ministries and departments.[39] Since the launch of NSWS, there have been over 420,000 unique visitors from 157 countries on NSWS.[40] Various government schemes, including a vehicle scrapping policy, an Indian footwear and leather development policy, and a national programme on high efficiency solar photovoltaic modules under PLI schemes have been onboarded on NSWS.[41]

II YEAR IN REVIEW

i Disclosure obligations under the Companies Act, 2013 in tandem with Press Note No. 3

The NDI Rules read with Press Note No. 3 of 2020 (Press Note 3) stipulate an obligation to obtain prior government approval for investment in equity instruments of an Indian company by an investor company incorporated or registered in a restricted country, or a beneficial owner of such investment that is situated in or is a citizen of a restricted country. Non-compliance with this obligation attracts penalties under FEMA.

The Ministry of Corporate Affairs has amended various rules under the Companies Act, 2013 (Companies Act) to align them with Press Note 3, including the following:

- Amendment to the Companies (Share Capital and Debentures) Rules, 2014, dated 4 May 2022: the transfer of shares to a person or entity from a restricted country requires the transferee to provide a declaration to the Indian investee company stating whether or not it is required to obtain government approval as per the NDI Rules, and that if such government approval is required, it has been obtained. A copy of the approval letter is required to be attached with a securities transfer form (Form SH-4), which is to be submitted to the Indian company.[42]
- Amendment to the Companies (Prospectus and Allotment of Securities) Rules, 2014, dated 5 May 2022: in the case of a private placement of securities, the Indian investee company is required to ensure that no offer or invitation of any securities is made to any person or entity from a restricted country without having obtained government approval. Further, the applicant to the private placement of securities (i.e., the investor) is required to confirm whether or not it is required to obtain government approval prior to subscription of shares, and that if such government approval is required, it has been obtained. A copy of the approval letter is required to be annexed to Form PAS-4 (private placement offer cum application letter) in the event that the applicant is required to obtain government approval under the NDI Rules.[43]
- Amendment to the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, dated 30 May 2022: for any compromise, merger, amalgamation or demerger between an Indian company and a company or body corporate incorporated

in a restricted country, a declaration confirming whether or not the company or body corporate is required to obtain prior approval under the NDI Rules is required to be submitted with the application under Section 230 of the Companies Act. A copy of the approval letter is required to be annexed to Form CAA.16 in the event that the company or body corporate is required to obtain government approval under the NDI Rules.[44]

- Amendment to the Companies (Incorporation) Rules, 2014, dated 20 May 2022, (effective from 1 June 2022): the subscribers to the memorandum of association and the first directors of a new company incorporated under the Companies Act are required to provide a declaration stating whether or not they are required to obtain government approval as per the NDI Rules, and that if they are required to obtain such approval, it has been obtained. Where applicable, a copy of the approval letter is required to be annexed to Form INC-32 (SPICe+).[45]
- Amendment to the Companies (Appointment and Qualification of Directors) Rules, 2014, dated 1 June 2022: a mandatory security clearance from the Ministry of Home Affairs (MHA) is required to be obtained and attached with the consent letter for the appointment of a foreign national from a restricted country as a director in an Indian company. Further, such foreign national is required to confirm whether or not a security clearance from the MHA is required to be obtained, and that if such security clearance is required to be obtained, then it has been obtained. Where applicable, a copy of the security clearance from the MHA is required to be annexed to Forms DIR-2 and DIR-3.[46]

ii PLI scheme

To promote ease of doing business in India, the central government introduced the PLI scheme for large-scale electronic manufacturing on 1 April 2020, which provides an incentive of between 4 per cent and 6 per cent on the incremental sale of goods manufactured in India, and covers under target segments, to eligible companies, for a period of five years subsequent to the base year of 2019–2020.[47] To date, the PLI scheme has covered 14 sectors, including food processing, battery storage and pharmaceuticals.[48] The PLI scheme has revamped the manufacturing landscape of the Indian economy and has attracted several foreign investors across multiple sectors. A total of 733 applications have been approved under the PLI scheme, and sectors such as pharmaceuticals, food processing, medical appliances and telecoms, etc., have seen an increase in FDI inflows from FY 2021–2022 to FY 2022–2023.[49] PLI schemes have contributed to an around 76 per cent increase in the manufacturing sector and, in particular, bringing a value addition of around 20 per cent in mobile manufacturing in three years.[50]

iii NLP 2022

In order to promote seamless movement of goods across India and to enhance logistics efficiency in terms of infrastructure, services (digital systems and processes) and human resources, the Indian government launched the NLP on 17 September 2022. The NLP aims to (1) boost exports from India by reducing the logistics costs in India from the current levels of 13 to 14 per cent of GDP to single-digit figures and (2) enhance the competitiveness of Indian goods. As part of the NLP, a unified logistics interface platform is proposed to be set up to consolidate digital transportation services and ensure ease of logistics services and user issues resolution. Additionally, a system improvement group is proposed for monitoring and coordination a mechanism for unresolved user issues.[51]

iv Schemes for promotion of the semiconductor industry

Recognising the importance of semiconductors in the world economy, the government launched several schemes, such as the Modified Scheme for setting up of Semiconductor Fabs and Display Fabs in India; the Modified Assembly, Testing, Marking and Packaging (ATMP) Scheme; and the Semicon India Future Design: Design Linked Incentive Scheme,[52] which provide fiscal support of up to 50 per cent of project costs.[53] In light of the financial impetus being provided by the government under these schemes, several multinational companies have shown interest in investing in the semiconductor industry in India. In June 2023, US-based memory chip company Micron Technology, Inc announced that it would invest up to US$825 million in a new chip assembly and test facility in Gujarat, India, with financial support of 50 per cent of the project costs from the central government under the ATMP Scheme and incentives representing 20 per cent of the total project cost from the state of Gujarat.[54]

v Significant investments

Foreign investment has been strong despite the challenges of the global economic slowdown resulting from the covid-19 pandemic, the supply chain disruptions trigged by the Russia–Ukraine conflict and high inflation. India recorded the highest ever total FDI equity inflow of US$84.43 billion in FY 2021–2022 and witnessed resilient growth in the FDI equity inflow of approximately US$27 billion in the first half of 2022–2023. Among developing countries, India has been recognised as one of the largest recipients of FDI for research and development centres by multinational companies.

The two most prominent trends in M&A in India in the previous year were increased consolidation and disposal of non-core assets. There has been a 40 per cent decline in global deal value in 2022 as compared with 2021.[55] However, despite the global slowdown in M&A, India witnessed growth in terms of 114 per cent growth in deal value at around US$111 billion and 25 per cent growth in corporate divestiture in 2022 as compared with 2021.[56]

Noteworthy investments include GIC's US$51 million investment in Skyroot Aerospace, which is the first private company from India to launch a rocket into space, and Shell's acquisition of Solenergi Power Private Limited and the Sprng Energy group of companies (a renewable energy platform) from Actis Solenergi Limited, at a deal value of US$1.55 billion.[57] Sembcorp Energy India Limited was acquired by Tanweer Infrastructure SAOC.[58] Abu Dhabi-based international holding company PJSC invested in three Adani portfolio companies – Adani Green Energy, Adani Transmission and Adani Enterprises – at a deal value of approximately US$2 billion.[59]

Sumitomo Mitsui Banking Corporation, the Asian Infrastructure Investment Bank and private equity firm Intermediate Capital Group have agreed to invest US$250 million in Amp Energy India in the renewable energy sector.[60] Foxconn plans to invest US$600 million in India.[61] Amazon Web Services, Inc has proposed investing US$12.7 billion into cloud infrastructure in India by 2030.[62] Other significant deals include Abdul Latif Jameel's investment in Greaves Electric Mobility Private Limited[63] and Cinesite's acquisition of a majority stake in Assemblage, an animation studio in India in November 2022.[64]

Private equity and venture capital investments in India from abroad were robust, valued at US$61.6 billion.[65] The key growth sectors included manufacturing, energy, healthcare and fintech.[66] Tata Power Renewable Energy Limited secured a US$525 million equity investment from BlackRock Real Assets and Mubadala Investment Co and UK-based GreenForest New Energies Bidco.[67] Other notable investments include Carlyle Group's and Advent International's acquisition of a 9.99 per cent stake in Yes Bank Limited, valued at approximately US$1 billion;[68] TPG Rise Climate's investment of about US$500 million in Tata Motors for its electric vehicles business;[69] KKR & Co's investment of US$450 million in Hero Future Energies, US$250 million in Serentica Renewables[70] and US$300 million in Advanta Enterprises;[71] General Atlantic's investment of US$450 million in PhonePe;[72] and Ontario Teachers' Pension Plan Board's acquisition of a majority stake in Sahyadri Hospitals Group from Everstone Group.[73]

III FOREIGN INVESTMENT REGIME

i Policy

Given that foreign investment is a significant factor in economic growth, the central government has progressively liberalised foreign investments, permitting 100 per cent investment in most sectors without requiring prior government approval. However, sectors concerning national security, public interest and data security, such as defence and space, and multi-brand retail, remain exceptions.

All FDI proposals requiring government approval must be filed on the NSWS portal. Further, as mentioned above, all foreign investment proposals (including changes in beneficial ownership, either directly or indirectly) from restricted countries are mandatorily required to be screened, regardless of the sector and whether it is under the automatic route or the government route.[74]

ii Laws and regulations

The relevant laws and regulations have been mentioned in Section I, above. The DPIIT is the nodal authority for foreign investment in India. Operating under the Ministry of Commerce and Industry, the DPIIT promotes industrial development, facilitates investment in new technology, aids ease of doing business in India and promotes FDI in India. The DPIIT collaborates with the RBI and the relevant central government ministry or department. There are certain mandatory reporting requirements with the RBI for any foreign investment in India. Additionally, the Competition Commission of India (CCI) is India's antitrust regulator and plays an important part in screening foreign investment proposals that cross the threshold specified within the Competition Act, 2002 (Competition Act) and the rules thereunder. Depending on the sector, certain conditions may also be imposed by sectoral regulators. For example, the insurance sector is regulated by the Insurance Regulatory and Development Authority, the telecommunications sector is regulated by the Department of Telecommunications, the mining sector is regulated by the Ministry of Mines and the defence sector is regulated by the Ministry of Defence.

iii Voluntary screening

There is no voluntary screening requirement in India. However, foreign investors may file representations to the DPIIT through industry bodies to seek informal guidance. If required, a formal request for clarification may be made. The DPIIT, in several cases, has issued clarifications upon receiving requests from industry bodies.

iv Procedures

Investment in a sector requiring government approval

Proposals for foreign investment in a sector requiring government approval are to be filed on an integrated portal for government approval (i.e., the NSWS portal) along with the requisite documents. Thereafter, based on the business activity of the investee company, the proposal is forwarded to the relevant ministry or department by the DPIIT. All the relevant documents in relation to the FDI proposal are required to be digitally signed by its authorised representative and uploaded on the NSWS portal. The DPIIT then circulates the proposal to the other concerned stakeholders, such as:

- the RBI for feedback in relation to FEMA;
- the MHA for security clearance; and
- the Ministry of External Affairs for information.

The competent authority may seek additional documents and information from the applicant after scrutinising the proposal. Once the processing of the proposal is complete, the competent authority issues the approval letter to the applicant. For timely disposal of delayed FDI proposals and proposals escalated by the competent authority for quicker disposal, an inter-ministerial committee consisting of representatives from the DPIIT, the Department of Economic Affairs, the Ministry of Corporate Affairs, the MHA, the competent authority, the RBI and Niti Ayog has also been constituted. While the standard operating procedure prescribes a 10- to 12-week timeline from the date of filing an application for the decision to be communicated to the applicant, it takes approximately four to eight months for disposal of such applications. The time taken by the applicant to provide clarifications or relevant documents to the relevant ministry or department is not included within such timeline.[75]

Foreign investment proposals above 50 billion rupees are also placed before the Cabinet Committee on Economic Affairs for approval, which will further extend the timeline indicated above.[76]

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

FDI is prohibited in specific sectors, including the lottery business, gambling and betting activities, trading in transferable development rights, real estate businesses or construction of farmhouses, and activities or sectors not open to private sector investment, such as atomic energy and railway operations (other than the permitted railway infrastructure).[77]

ii Restricted sectors

Foreign investments in certain sectors are restricted, requiring prior government approval or with the application of additional obligations. Such sectors include:[78]

- defence: FDI up to 74 per cent is permitted under the automatic route and beyond 74 per cent under the government route wherever it is likely to result in access to modern technology or for other reasons to be recorded. Such an investment is subject to security clearance by the MHA and according to guidelines of the Ministry of Defence;
- multi-brand retail trading: FDI up to 51 per cent is permissible under the government route subject to certain specified conditions;
- insurance (apart from insurance intermediaries): currently, FDI up to 74 per cent is permitted through the automatic route subject to sectoral conditions; and
- the brownfield pharmaceutical sector: FDI up to 74 per cent is permitted under the automatic route and beyond 74 per cent under the government route. FDI in this sector is subject to specified restrictions and conditions, including restrictions on the incorporation of non-compete clauses in the relevant investment agreements.

V TYPICAL TRANSACTIONAL STRUCTURES

Foreign investors typically establish their presence in India by either setting up a company in India or acquiring an existing one.

In the past, foreign investors preferred investing in brownfield projects due to their established nature and lower compliance burden. However, particularly with the implementation of the PLI scheme, there has been an increase in greenfield investments. There are also distinct advantages to brownfield JVs or acquisition of a greenfield JV. For instance, brownfield investments provide access to existing manufacturing facilities and distribution channels, while greenfield investments can exploit market inefficiencies.

With the impact of the covid-19 pandemic, companies in India have shifted focus to core business operations, leading to an increase in business transfer, slump sale or asset transfer arrangements to divest non-core assets. Business transfers that constitute a slump sale are also preferred because they have lower tax implications.

Set out below is a summary of legal considerations for foreign investors in India.

i JVs

Foreign companies and investors can form JVs in India subject to the restrictions discussed above.[79] JVs offer flexibility and operational ease. Forming a JV with an Indian partner or entity provides the foreign investor with access to the local market, know-how, and access to existing manufacturing facilities and distribution networks. Key factors for a successful JV include:

- a credible business partner;
- a robust business plan;
- business activities and related opportunities;
- an optimal investment structure and inter se rights of the parties;
- a competent management team; and
- transparent operations.

There have been several successful JVs between an Indian entity and a foreign investor, such as Maruti Suzuki. However, there are certain risks associated with the JV model, such as the possibility of financial leakages, deadlock on critical operational decisions leading to forced exits or change in control of the JV company.

ii Corporate law residency requirements

The Companies Act permits foreign nationals to serve as a director, provided that there is at least one director who has resided in India for 182 days.[80] Appropriate relaxations were provided to the applicability of this provision owing to the covid-19 pandemic.[81] However, the appointment of a foreign national as a managing director or full-time director will need central government approval if their period of residency in India before appointment is less than 12 months.[82]

iii Rules pertaining to takeover bids by foreign companies

The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the Takeover Code) governs the takeover regime in India. The Takeover Code was introduced with the objective not only of providing a transparent corporate governance system for takeovers involving listed entities but also to protect the interests of the investors by allowing them an exit opportunity. The Takeover Code seeks to restrict and regulate both direct and indirect acquisition of control, shares or voting rights in a listed entity. If such an acquisition leads to a breach of threshold limits under the Takeover Code or there is change in control, the acquirer is obliged to make an open offer to the public shareholders to acquire their shares in the listed company. This ensures a fair and transparent exit mechanism for the shareholders. The Takeover Code also allows another prospective acquirer to make a counter-offer, thereby ensuring fair and effective competition between acquirers.

iv Other corporate structures for ownership

Other than companies, limited liability partnerships (LLPs) are also a corporate structure favoured by foreign investors. Unlike a traditional partnership, partners in an LLP do not have a personal liability. An LLP, like a company, has a separate legal personality. However, foreign investors can invest in those LLPs only where 100 per cent FDI is allowed under the automatic approval route and no sectoral conditions are applicable. To further ease doing business and foster the start-up ecosystem in India, in recent years, amendments have been introduced to decriminalise various minor, technical and compliance-related offences. These offences are now subject to an internal adjudication mechanism.[83]

VI OTHER STRATEGIC CONSIDERATIONS

i Strategic considerations

There are certain factors that foreign investors should consider before investing in India, such as the key opportunity sectors in India; mode of investment; nature of business operations; FDI restrictions (if any) in the proposed business; approvals required from central government, the RBI or other sectoral regulators for setting up a business; availability of land; incentives being provided by various states in India; and special benefits and incentives for setting up a business in special economic zones. Furthermore, owing to the effects of the covid-19 pandemic, consolidation is occurring in various industries, and behemoths are looking to sell non-core assets to raise liquidity for their core assets and to better manage their core assets. This can be a consideration for a foreign investor who is looking for a bargain.

ii Merger control regime in India

Mergers and acquisitions in India are also governed by the Competition Act, allied regulations, notifications and guidance notes issued thereunder. Sections 5 and 6 of the Competition Act require the pre-notification of all acquisitions, mergers and amalgamations to the CCI where the turnover or assets of the parties or groups cross specified thresholds (collectively described as 'combinations') and are not otherwise exempt. The CCI is responsible for merger review and applies the standard of appreciable adverse effect on competition (AAEC). India follows a mandatory and suspensory merger control regime, and notifiable combinations may not be consummated in any way until clearance has been given by the CCI (or the prescribed timeline has passed without decision). Failure to notify and gun-jumping attract significant penalties.

The CCI's review process consists of two phases. In Phase I, the CCI will form its prima facie opinion of whether or not the combination is likely to cause or has caused an AAEC within the relevant market. If there are no prima facie AAEC concerns, the CCI will clear the combination in Phase I itself. If the CCI believes that the combination prima facie raises AAEC concerns, the transaction moves to a Phase II review, which is a more detailed and intrusive assessment of the combination. In undertaking its assessment on whether the combination causes or is likely to cause an AAEC, the CCI will look at a number of factors set out under Section 20(4) of the Competition Act, including market shares, barriers to entry, ability to raise prices after completion of the transaction and countervailing buyer power.

The existing merger control regime shall soon undergo substantial changes once the relevant provisions of the Competition (Amendment) Act, 2023 (the Amendment Act) are brought into effect. The salient features of the Amendment Act are as follows:[84]

- the Amendment Act envisages a new 'deal value' threshold under Section 5 of the Competition Act by providing that CCI approval shall be required if the value of any transaction exceeds 20 billion rupees and if the target has 'substantial business operations in India';
- the Amendment Act envisages codifying the definition of 'control' to mean the ability to exercise 'material influence' over the management or affairs or strategic commercial decisions of a company;
- the Amendment Act envisages shortening the overall approval timeline to 150 days (previously, it was 210 days). It further requires the CCI to form a prima facie view on a combination within 30 days of receipt of notice, failing which the combination shall be deemed to be approved by CCI; and
- for the first time, the Amendment Act envisages derogation of standstill or suspensory obligations for certain open-market purchases. For such transactions, a notification form may be filed post-consummation of the transaction.

VII OUTLOOK

India stands out as a lucrative destination for foreign investment despite the escalating geopolitical uncertainties and a cautionary investment approach at a global level. With notable growth in FDI inflows across different sectors, amid the economic aftershocks of events such as the Russia–Ukraine conflict and the covid-19 pandemic, India has reinforced itself as a stable and reliable economy with vast potential for foreign investors to leverage investment opportunities in India. Several factors underscore India's investment appeal. India's technological advancements, low leverage and favourable demographics are some of the key factors in investment growth in India. Various laws and policies, as discussed above, including the PLI schemes, NLP, Indian Space Policy and NSWS, etc., have been meticulously crafted to attract foreign investment in India. The continued liberalisation, coupled with numerous economic reforms, is marked by a favourable growth in foreign investment in India. This has not only fostered India's integration into the global supply chain, thereby characterising it as a global manufacturing hub, but also significantly contributed towards increasing foreign investment in the manufacturing sector.

Despite the global economic slowdown, the Organisation for Economic Co-operation and Development has forecasted that India's GDP will continue to grow at a rate of 5.7 per cent for FY 2023–2024, and expects India to be the second fastest-growing economy in the G20 in 2023–2024. Thus, the policies and reforms are significantly aligned towards tapping global investments. Foreign investors may benefit further by exploring investment opportunities in growth-driven sectors in India such as renewable energy, start-ups, real estate and electronics, among others, marked by a series of structural economic reforms in India.

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Chapter 12

Israel

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Summary

I OVERVIEW

Widely recognised as the 'start-up nation', Israel is known for its abundance of cutting-edge technological innovations in a wide variety of fields (cybersecurity, artificial intelligence, autonomous mobility, energy, digital health, fintech, agritech and others), garnering great interest from international investors such as venture capital firms, private equity funds and multinational corporations and other strategic players.

Israel has no general unified foreign direct investment (FDI) legislation or approval regime. As a result, there are no broad cross-sector consolidated controls on foreign investments in the country. Generally, foreign entities can purchase and sell assets and securities in Israel at will, and FDI is not categorically prohibited in any particular sector. That said, there is a series of stand-alone, sector-specific FDI regulations and requirements.

Such restrictions and requirements often pertain to investments in companies operating in public utility and infrastructure fields or those affecting national security. FDI requirements may also stem from terms included in government licences, public tenders or concessions.

Under Israel's regulatory structure, regulators overseeing a specific sector can generally exercise relatively wide discretion in issuing and revoking licences, concessions and permits. As such, regulators can include specific conditions, restrictions or approval requirements regarding FDI and subsequently alter them as they see fit. The exercise of regulatory discretion, as well as any action by a regulator, is subject to the principle of legality, the rules of the administrative process and the principles of judicial review of administrative discretion.

Alongside the FDI-related obligations that may be implemented in licences, concessions and permits, contractual regulations have become increasingly common in Israel. FDI conditions can also be found in agreements between the government and private entities.

Despite the generally decentralised nature of FDI regulation in Israel, a centralised mechanism for examining foreign investments from a national security perspective was formulated in 2019 in the form of the Advisory Committee for National Security Affairs in Foreign Investments (the Advisory Committee), which is discussed below.

II YEAR IN REVIEW

This past year, foreign entities participated in extensive activities in Israel despite the aftershocks of the worldwide covid-19 crisis, a global drop in venture capital investment, international instability due to the war in Ukraine and Israel's own political unrest, including the government's ongoing attempts to implement major judicial reform. As the 'start-up nation', Israel is greatly influenced by global markets in venture capital and investment in technology, which generates a far greater share of the overall investment in the Israeli economy when compared with other developed countries. As a result of the global drop in venture capital investment and the current political climate (particularly since January 2023), Israel saw an overall decline in foreign investment in the past year. Although 2022 was still a strong year for venture capital investment, with US$15.5 billion invested, this was a significant plunge from the 2021 figure of over US$27 billion. Nonetheless, this decline can also be partly explained by abnormally high investment activity from the prior two years.[2]

That being said, the levels of FDI activity in Israel (US$27 billion in 2022, compared with the US$21.5 billion invested in 2021 and US$23.1 billion invested in 2020)[3] exemplify the ease with which foreign investors can do business in Israel.

Foreign investments and the involvement of foreign companies in Israeli innovation reached a broad range of diverse fields in 2022, such as high-tech, energy and infrastructure.The year 2022 saw a significant rise in climate tech funding: the same amount invested in the first half of 2021 was reached in just one quarter in 2022.

FDI has increased over the years in Israel, with companies looking to invest in large infrastructure projects, including ports and mass transit.

In October 2019, the Ministerial Committee for National Security Affairs resolved to establish a protocol for examining national security concerns in foreign investments. Pursuant to this decision, an advisory committee headed by the Ministry of Finance's chief economist was established and subsequently tasked with examining national security concerns arising from foreign investments.

The Advisory Committee began its work in 2020, establishing a mechanism to handle regulator queries concerning transactions that may give rise to national security considerations. These could include cases lacking previous FDI regulatory requirements, as well as government tenders, following a 2022 amendment to the 2019 resolution. The Advisory Committee bases its recommendations on confidential criteria. Formally, the regulator is charged with making the final decision about the transaction. However, the Advisory Committee's recommendations carry substantial weight with sectoral regulators.

Neither the transactions the Advisory Committee monitors and evaluates nor its recommendations to regulators are made public. However, according to its report on its activity in 2021, the Advisory Committee examined potential transactions worth approximately 36 billion shekels during that period. In comparison, total foreign investment transactions made during the same period are estimated to be worth approximately US$47 billion.

Existing legislation also includes substantial oversight powers over national security considerations in foreign investments, as used by Israeli defence establishments to control foreign investments. The Advisory Committee, however, serves as a centralising body that aims to ensure more encompassing and effective scrutiny of national security concerns across those sectors that the government views as critical to the economy and national security.

III FOREIGN INVESTMENT REGIME

Laws and regulations

At present, there are no centralised FDI regulations in Israel. As a result, regulators have no unified cross-sector considerations to refer to when examining foreign investments. At the same time, general FDI regulatory requirements may apply to a broad range of transactions, regardless of their sector, primarily restrictions deriving from national security considerations, restrictions on transactions that entail the purchase of land and requirements linked to state tenders.

National security legislation

In addition to establishing the Advisory Committee, Israel has implemented various laws designed to protect its security interests, particularly with respect to national security concerns pertaining to investments made by foreign entities. A summary of each of the main laws is provided below.

Defence Corporations Law (Protection of Security Interests) of 2006

The Defence Corporations Law (Protection of Security Interests) of 2006 (DCL) authorises the Prime Minister, the Minister of Defence and the Minister of Economy and Industry (the Ministers) to declare a corporation as a 'defence corporation' when its principal activity is engagement in defence-related know-how or the use of equipment by security forces,[4] provided that they find that national security could be harmed, under certain circumstances. Such circumstances can include acquiring or holding control or means of control in the corporation, a venture or merger of the corporation with another entity or the transfer of know-how relating to the corporation or its activity.[5]

Corporations declared as defence corporations are subject to regulatory oversight, including restrictions on the transfer, acquisition and ownership of their means of control – all contingent upon approval by the Minister of Defence.[6]

The Ministers are also entitled to set Israeli nationality requirements with respect to the control of a defence corporation and its officers, as well as residency requirements, such that the ongoing management of a defence corporation and its centre of business is done in

Israel.[7] Additionally, they can require a defence corporation to obtain prior approval from the Minister of Defence before entering into a joint venture or changing its corporate structure,[8] and to place restrictions on the transfer of security know-how to officers or shareholders or to any corporation that has considerable influence on the defence corporation.[9]

Defence Export Control Law of 2007

The Defence Export Control Law of 2007 (DECL) regulates the sale and export of defence equipment, including any equipment or technology sold to or intended for use by security forces.[10] The DECL applies to the sale of defence equipment and the transfer of defence know-how outside Israel and therefore is broader than the DCL in scope. Under the DECL, any company selling or exporting defence equipment or information must be registered and licensed by the Ministry of Defence and must report any changes to its control structure.[11]

The DECL also regulates the sale of dual-use equipment, as defined by the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies, according to the identity of the end user of said equipment. Dual-use equipment sold to or intended to be used by security forces is considered a defence export and thus fits within the scope of the DECL, including its relevant FDI restrictions.[12] However, the Ministry of Economy must license any equipment exports to civilian end users.[13]

Trade with the Enemy Ordinance of 1939

The Trade with the Enemy Ordinance of 1939 prohibits direct or indirect trade between the state of Israel or its citizens (including corporations) and an enemy state, an entity in an enemy state or an enemy subject or for the benefit of any of the foregoing.

Law on the Struggle Against Iran's Nuclear Programme of 2012

The Law on the Struggle Against Iran's Nuclear Programme of 2012 imposes sanctions against foreign entities acting in a foreign country to assist Iran in advancing its nuclear programme or obtaining weapons of mass destruction. The Law sets restrictions and sanctions on corporations that sustain business connections with Iran, for Iran's benefit or in Iranian territory.

Law for the Prevention of Distribution and Financing of Weapons of Mass Destruction of 2018

The Law for the Prevention of Distribution and Financing of Weapons of Mass Destruction of 2018 prohibits any engagement in economic activity with an entity declared (by the United Nations Security Council or by order of the Minister of Finance in consultation with the Minister of Foreign Affairs and the Minister of Defence) as serving as an accessory to the distribution and financing of weapons of mass destruction or with an entity related to that assisting entity unless that entity has received explicit permission from the Minister of Finance.[14]

Real estate

The Israeli government oversees the transfer of Israeli land to non-Israelis under the Israel Land Law of 1960 (the Land Law). This Law forbids the transfer of 'property rights', by sale or otherwise, pertaining to Israeli land to non-Israeli entities without first obtaining permission from the chair of the Israeli Land Council.

The Land Law defines 'property rights' very broadly, including ownership rights, the right to lease property for more than five years or extending a lease for an aggregate period exceeding five years, as well as an undertaking to transfer those ownership or leasing rights.

The transfer of property rights requires the chair to first consult with the Minister of Defence and the Minister of Foreign Affairs and then consider, among other things, the buyer's identity, the buyer's relationship to Israel, the purpose of the purchase, and the public's best interests and security before approval can be granted.

Any transaction that requires prior approval by the chair and does not receive final approval is void. The Attorney General or any interested party is entitled to file a motion in court to declare the transaction void, to negate any registration made with respect to the transaction in any official registry or to request any other remedy that the court may find appropriate.

Government tenders

Tenders published by the state of Israel and public entities are governed by the Mandatory Tenders Law of 1992 (the Tenders Law). FDI oversight may be exercised through conditions set in tenders and procurement contracts.[15]

One of the sources for general authority to exercise oversight can be found in a provision of the Tenders Law authorising the Israeli government, as approved by the Foreign Affairs and Defence Committee of the Knesset (the Israeli Parliament), to order that the state of Israel or a government corporation not enter into a transaction with a particular foreign country or supplier based on foreign policy considerations.[16]

The regulations promulgated under the Tenders Law also established mechanisms to encourage government procurement of goods made in Israel. These, in turn, may affect foreign entities' chances of winning government tenders.

For example, the Mandatory Tenders Regulations (Duty of Industrial Cooperation) of 2007 (the Industrial Cooperation Regulations) stipulate that the Israeli government and other public entities must engage in reciprocal purchases when purchases are made from a foreign entity and through government tenders.[17] In such a case, when purchases exceed US$5 million, the foreign supplier is obliged to purchase products and services in certain amounts from Israeli entities as well.[18]

The scope of this purchase requirement varies according to the type of transaction.[19] In non-military transactions with a company based in countries that are parties to the Government Procurement Agreement, the foreign company is obliged to reciprocate with a purchase from Israeli suppliers worth 20 per cent of the value of the contract. In national security transactions, the purchase must be worth 50 per cent of the value of the contract. In all other transactions, the obligation would be 35 per cent.[20] In certain situations, the Industrial Cooperation Authority at the Ministry of Economy may waive or ease the requirements.

According to the Mandatory Tenders Regulations (Preference for Israeli Products) of 1995 (the Made in Israel Regulations), the state, as well as government corporations, must give priority to bidders that undertake to supply Israeli-made goods within the framework of public tenders.[21]

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

Foreign investments are not categorically prohibited in any particular sector. Rather, Israeli government policy is generally encouraging towards foreign investments. Several key examples of sectoral regulatory limitations and oversight powers pertaining to foreign investments in Israel are discussed below.

ii Restricted sectors

Former state-owned entities that have undergone privatisation

Companies formerly under government control and those that are undergoing or have undergone privatisation are subject to specific regulations regarding foreign investments. The government has special oversight authority over such companies. The main legislative act in this context is the Government Companies Act of 1975 (the Government Companies Act).

Under the Government Companies Act, the Ministerial Committee on Privatisation is entitled to issue an order declaring that the state has essential interests in a government company about to be privatised. Among these essential interests may be the need to maintain the company's Israeli identity and to keep its centre of business and management in Israel.

To transfer control of entities subject to such an order, prior approval must first be obtained from the Minister of Finance and the minister in charge of the company's field of activity.[22] Under such an order, the government may also apply further restrictions on the privatised company's activities, including restrictions on the transfer of means of control in the company to foreign investors; restrictions on the transfer of company assets outside Israel, Israeli nationality requirements regarding the company's officers, and a condition requiring the company's centre of business and operations to be established and remain in Israel.

To date, the state has issued five Essential Interests Orders, all of which include restrictions concerning the former state-owned entity's Israeli identity.[23]

Communications sector

Activity within Israel's communications infrastructure fields may require companies to obtain licences, permits or concessions from the state. Depending on the specific area of activity, these government approvals may also include FDI requirements.

The Communications (Telecommunications and Broadcast) Law of 1982 (the Telecommunications Law) was significantly amended in July 2022, replacing the licensing regime for many telecommunications services with a registration regime. However, the amendment does not substantially change the existing regulatory regime in areas considered sensitive, which still include certain limitations on foreign investments in Israeli telecommunications companies.

Various Israeli nationality requirements serve as preconditions for issuing licences to provide certain communication services, such as television broadcasting and satellite services based in Israel.[24] Examples include the corporation's place of registration and the nationality of its executives, directors and shareholders. It should be noted that significant reform to the existing regulation regarding the broadcast and television sectors was introduced in July 2023 in a bill proposed by the Ministry of Communications. Such reform, if implemented, could replace the existing licensing requirements with registration requirements, possibly altering existing FDI regulations.

In addition, the Prime Minister and the Minister of Communications may set out various Israeli nationality requirements with regard to a telecommunications corporation declared as an 'essential service provider'.[25] The transfer or acquisition of control, 'significant influence' or means of control in an essential service provider requires prior approval from these ministers.

Natural gas sector

The development of Israel's natural gas sector has accelerated since the discovery of three vast reservoirs of natural gas in 2009. Foreign entities are extensively involved in Israel's natural gas exploration and drilling operations. Since 2016, the Ministry of Energy has issued tenders for obtaining licences for natural gas exploration in Israeli waters. To date, more than a dozen natural gas and oil exploration licences have been issued – many to foreign entities – with additional tenders under way.[26]

The exploration, development and production of natural gas and oil in Israel are subject to extensive regulation. The Petroleum Law of 1952 regulates the granting of 'petroleum rights' (a licence or possession rights). A licence grants the right to explore and drill for petroleum within a defined area, the right to extract petroleum from that defined area and the right to take possession of the discovered petroleum.

This regulatory framework also addresses foreign entities' ability to operate within this field. The Petroleum Regulations (Principles of Action for Petroleum Exploration and Production at Sea) of 2016 (the Petroleum Regulations)[27] grant the Ministry of Energy's Commissioner of Petroleum Affairs the authority to reject an application for petroleum rights under various circumstances, including when the applicant's controlling shareholder is a foreign country. The Commissioner has wide discretion to reject such applications based on national security, foreign relations or international commercial trade considerations.

In addition, the Natural Gas Economy Law of 2002 (the Natural Gas Economy Law) provides that a licence for natural gas operations may be granted only to a company incorporated in Israel.[28] It also authorises the Minister to stipulate in the licence that the licence-holding entity must be physically managed in Israel and that certain officials must be Israeli citizens and residents with a suitable security clearance.[29]

Electricity sector

Israel's electricity sector is highly regulated, with a single entity, the Israel Electric Company, controlling most of its conduction and production infrastructure. However, the privatisation of existing power plants, the construction of privately owned production facilities and the transfer of system management capabilities to a separate entity have opened up the electricity production market in recent years.[30]

Although the Israel Electricity Authority has declared its commitment to decentralise the Israeli power grid and allow entrepreneurs easier access to the electricity production and conduction markets, this remains a highly regulated sector. The ability to operate within each of its segments is subject to obtaining the relevant government licences.[31]

The Electricity Market Law of 1996 (EML) imposes limitations on foreign investments with regard to licences issued under this Law. For example, the transfer or acquisition of control of a licensed entity is subject to prior approval by the Israel Electricity Authority. If the licence pertains to an essential service provider,[32] holding any means of control also requires approval.

The EML also authorises the Minister of Energy to stipulate Israeli nationality requirements for essential service provider licence holders, such as limits on the rate of means of control held by non-Israelis, and requirements that certain officers within the licence-holding entity must be Israeli citizens and residents.

Financial sector

The financial services and banking sectors are heavily regulated. Investments in financial entities supervised by the Supervisor of Banks (the Supervisor) or the Commissioner of the Capital Market, Insurance and Savings (the Commissioner)[33] are mostly subject to regulatory permits.[34] Financial regulations stipulate many preconditions for receiving such permits, including unique limitations on foreign investments. It is within the relevant regulators' purview to determine whether a foreign applicant fulfils such preconditions and qualifies for the requested permit.

Investment in insurers and provident funds

Any entity holding more than five per cent of a particular means of control in an 'institutional entity'[35] requires a 'permit to hold a means of control' granted by the Commissioner.[36] Investments involving the purchase of 'control' are subject to a 'control permit' obtained from the Commissioner.

A foreign banking corporation or foreign institutional entity applying for a permit to hold a means of control in an Israeli institutional entity must meet unique requirements. Among such conditions, the foreign banking corporation or foreign institutional entity must have sufficiently large operations and suitable experience in the field, as determined by the Commissioner. The foreign corporation or entity must be subject to supervision in its home country, where banking or financial institution regulations must apply a model of capital, corporate and risk management requirements similar to those in effect in Israel (or provide a level of supervision at least equivalent to that in Israel). Additionally, the parties holding control of the foreign entity must satisfy at least the same reliability standards required for a controlling shareholder in an Israeli institutional entity.[37]

Investment in a banking corporation

To hold more than five per cent of a certain type of means of control in a banking corporation, the investor must obtain a 'permit to hold a means of control' from the governor of the Bank of Israel (the Governor)[38] (i.e., acquiring 'control' is subject to obtaining a 'control permit' from the Governor).[39]

An application for a control permit by a foreign bank will require the Governor to examine certain criteria (in addition to those examined regarding an Israeli investor). Banks in the foreign bank's country of origin must be subject to significant supervision meeting international standards (including implementation of the Basel Committee Guidelines) and be a 'first-tier global bank'.[40] Furthermore, there must be reciprocity with respect to corporate banking licensing between Israel and the applicant's country of origin.[41]

Investment in a processing or credit card company

A foreign entity's acquisition of control or a means of control in a processing or credit card company is subject to special conditions (in addition to those applied to an Israeli investor). These conditions include, but are not limited to, the following:

- A foreign processing company must hold a processing licence in a member country of the Organisation for Economic Co-operation and Development of a type and scope at least at the same level as those of the processing company that it wishes to acquire.
- The country in which the processing company and the companies in its chain of control are incorporated ('the parent countries') must not place any restrictions on capital transactions.
- The parent countries must impose supervision based on the same standards as in Israel.
- The parent countries must not be at high risk of falling prey to money laundering or the financing of terrorism.
- The supervisory authorities in the parent countries must consent to the holding of a processing company in Israel.
- The supervisory authorities in the parent countries must confirm that there are no restrictions on transferring information to the Supervisor of Banks in Israel concerning the foreign processing company and its activities.[42]

It should also be noted that the reporting requirements for a foreign investor applying for a processing company control permit are more extensive than those that would apply to an Israeli investor.

Regulation encouraging foreign investments in Israel

Israeli regulation is generally encouraging towards foreign investments. For example, the Law for the Encouragement of Capital Investments of 1959 (the Investment Law) incentivises industrial enterprises to make capital investments in productive assets such as production facilities.

A company with an approved enterprise programme under the Investment Law (an approved enterprise) is eligible for special tax benefits, provided that it qualifies as a foreign investors' company (i.e., more than 25 per cent of the controlling rights are held by foreign residents).

Undistributed income generated by an approved enterprise is exempt from corporate tax for a period of two to 10 years. For the remainder of the benefits period, an approved enterprise is entitled to a reduced corporate tax rate of 10 per cent to 20 per cent, depending on the percentage held by foreign investors in the company.[43]

Income generated by a 'preferred company' (including foreign companies) through its 'preferred enterprise' (including a company incorporated in Israel that has, among other things, 'preferred enterprise' status and is controlled and managed from Israel) can also be eligible for benefits, such as a reduced corporate tax rate of 16 per cent, which may be further reduced to 9 per cent or 7.5 per cent in applicable development zones.[44]

Income generated by a preferred company through its 'preferred technology enterprise' is eligible for benefits, including a reduced corporate tax rate of 12 per cent.[45] In addition, subject to the fulfilment of certain conditions, if dividends are paid to a direct foreign parent company holding at least 90 per cent of the preferred company's shares, a reduced withholding tax rate of 4 per cent applies.

In addition, in July 2023, the Knesset passed the Law for the Encouragement of High-Technology Industry (Temporary Order) of 2023. This Law, which has yet to be implemented in practice, is aimed at granting tax breaks to investors in Israeli high-tech start-up companies, including tax credits for individual investors in high-tech company stocks; deferral of capital gains payments for individual investors originating in the exchange of stocks of a preferred company holding a technological plant for those of another high-tech company; exemptions from Israeli taxes on interest and linkage differences paid by an Israeli high-tech company to foreign financial institutions; and the extension of the temporary order allowing, under certain circumstances, recognition of losses incurred in an investment in a public high-tech company, and a reduction of the conditions for receiving benefits from them.

V TYPICAL TRANSACTIONAL STRUCTURES

i General

Israel's regulation of foreign investments is relatively limited, and Israeli corporate practitioners are influenced by US-style corporate practices. Indeed, Israeli corporate lawmakers generally look to Delaware corporate law for trends and solutions. For example, there are generally no residency requirements for directors and officers of Israeli companies other than those in specific sensitive industries.

Israeli courts also tend to look to Delaware law for inspiration in corporate cases. They have adopted a modified version of the business judgement rule and are protective of foreign investors' rights.

Investors in Israeli companies can access the standard range of investment and acquisition options, such as the creation of preferred shares with US-style rights and the availability of all customary investor rights in venture capital investments.

Israel's corporate law is relatively extensively codified, having undergone several evolutions over the years. Key legislation includes the Companies Law of 1999 (the Companies Law), which regulates the activities of corporate entities in Israel, and the Securities Law of 1968, which regulates the Israeli capital market, primarily with respect to disclosure requirements and trading regulations, placing emphasis on public companies.

Given that many 'old industry' Israeli companies are traditionally controlled by a controlling shareholder, Israeli corporate law takes pains to protect minority shareholder rights. This is done by imposing fiduciary duties towards minority shareholders on controlling shareholders, which can benefit foreign minority investors.

ii Setting up a business in Israel

A foreign entity seeking to establish itself in Israel would typically either create a local branch (by registering as a 'foreign company') or be incorporated as an Israeli subsidiary of the foreign entity.

Becoming incorporated as a subsidiary in Israel means that the foreign company will own the shares of a separate legal entity in Israel, the subsidiary will pay taxes in Israel, and any transactions between the Israeli subsidiary and its foreign parent must comply with transfer pricing rules. Furthermore, any dividends paid by the Israeli subsidiary to its parent would be subject to withholding tax in Israel (i.e., they would be subject to any tax treaties between the jurisdictions involved).

A foreign company is not separate from the foreign entity but rather an extension of the foreign entity in Israel. Establishing a foreign company raises questions regarding a foreign entity's status as a permanent establishment in Israel for tax purposes, which should be explored before using the 'foreign company and local branch' option.

iii Joint ventures

Joint ventures are possible under Israeli law. Certain joint ventures may require registration as a 'general partnership' under Israel's Partnership Ordinance [New Version], 5735-1975.

As is generally the case with all corporations, Israeli law is very liberal when it comes to structuring joint ventures. Specific taxation aspects should be analysed prior to entering into a joint venture. Certain joint ventures may be subject to merger control or a restrictive arrangement regime if they meet certain requirements and satisfy jurisdictional thresholds (see Section VI, below).

iv Mergers and acquisitions

Generally, Israeli law does not place any major restrictions on how parties involved in a private merger or acquisition may structure the deal. Nor are there generally any limitations on the foreign ownership of Israeli companies, apart from industry-specific legislation, as discussed above. When multiple parties seek to acquire shares in a private company, they will customarily enter into a share purchase agreement containing provisions that are typically similar to those found in US private merger or acquisition deals (such as representations and warranties, interim period covenants, indemnification provisions and closing conditions).

The Companies Law also offers the possibility of a statutory 'bring-along': if a person offers to buy shares or a class of shares in a company, and the shareholders holding at least 80 per cent of the shares to be transferred agree to the acquisition proposal, the offeror may also acquire the shares of the other (non-accepting) shareholders, according to the terms proposed to the shareholders who accepted the proposal. This 80 per cent threshold is the default. Other rates may be agreed upon and prescribed in a company's articles of association.

A purchaser may acquire a company via the purchase of assets or a merger, with reverse triangular mergers becoming a preferred route for acquiring full ownership of Israeli companies. In this structure, a wholly owned Israeli subsidiary of the acquiring company, usually established for the purpose of the merger, merges with and into the target company, which then becomes a wholly owned subsidiary of the acquiring company.

As regards public companies, tender offers are also a possible method of acquisition. In this case, the acquirer offers to purchase all or some of the shares of the target company. If the acquiring company wishes to acquire the entire company, an offer may be made conditional on its successful acquisition. The Companies Law also includes 'squeeze out' mechanisms of minority shareholders.

A 'special' tender offer (as opposed to a 'full' tender offer) is triggered by any acquisition that results in the acquiring company crossing the 25 per cent or 45 per cent threshold in a company where, at the time of the offer, no single shareholder's holdings meet that threshold.

VI OTHER STRATEGIC CONSIDERATIONS

i Merger control

Depending on the circumstances at hand, joint ventures may be subject to merger control provisions or restrictive arrangement provisions as stipulated by the Israeli Economic Competition Law of 1988 (the Competition Law).

According to the Israel Competition Authority's (ICA) pre-merger guidelines, the distinction between a restrictive arrangement and a merger is not always clear. It may vary from case to case, as there is no conclusive litmus test but rather a substantive assessment of the transaction in question.

The nature of the joint venture has an impact on whether it is more likely to be viewed as a restrictive arrangement or a merger transaction. An important distinction here is between a joint venture that creates a new activity ('greenfield') with no transfer of existing assets into the joint venture (which will usually be classified as a restrictive arrangement) and a joint venture that grants one party influence over an existing activity of another party (which will usually be classified as a merger). Another important consideration is the expected duration of such joint venture's operations (generally, the more novel the activity for both parties and the shorter the joint venture's operation period, the greater the likelihood that the joint venture will be classified as a restrictive arrangement). Other considerations that affect the classification of joint ventures include the nature and strength of the link created between the parties, the nature of the structural integration and the stability of such ties.

General merger thresholds apply to foreign investments. A 'merger of companies' is defined under the Competition Law as the acquisition of (1) the principal assets of the target company; (2) more than 25 per cent of (i) the outstanding shares, (ii) the voting rights, (iii) the rights to appoint directors or (iv) the dividend rights of the target company; or (3) any transaction that creates a meaningful influence over the decisions of another corporation. A merger transaction must be reported to the ICA pursuant to the Competition Law, provided that at least two of the parties involved have sufficient nexus to Israel and at least one of three filing thresholds is met. Both the nexus requirement and the filing thresholds are evaluated on a group basis (i.e., including all entities that control or are controlled by the merging party and all entities controlled by those entities, whether directly or indirectly).

Nexus can be established by fulfilling any of the following alternatives:

- the party has any holding (direct or indirect) in an Israeli entity that exceeds 25 per cent of the voting rights, the rights to appoint directors, the dividend rights or the outstanding shares;
- the party has a registered office in Israel or is a registered corporation in Israel; or
- the party has a place of business in Israel either by conducting business in Israel directly (e.g., a physical presence such as a branch office or local employees) or by having influence over the commercial decisions of a local agent, representative or distributor (e.g., influence over matters such as pricing, terms for negotiations, marketing or inventory).

The filing thresholds are as follows:

- as a result of the transaction, the parties' combined market share exceeds 50 per cent at any level of the supply chain of any relevant market in Israel;
- the combined turnover of the parties to the merger in Israel exceeds 387.35 million shekels and the turnover of at least two parties is at least 20 million shekels;[46]
- a party to the transaction holds a monopoly in any defined market within Israel;[47] and
- in the case of foreign investments in Israeli assets, specifically in the industries listed in previous chapters, the ICA may consult the relevant sector-specific regulators about the potential implications of approval of the merger.

ii Additional considerations

As with any other jurisdiction, there are certain factors that foreign investors in Israeli entities or companies wishing to acquire Israeli entities should consider. We touch on two such factors that are typical areas of confusion for foreign players in the Israeli market: government funding and employment law.

Many Israeli companies receive grants from the Israeli Innovation Authority (IIA), which come with certain restrictions, such as those relating to where manufacturing takes place, how funded intellectual property is transferred out of Israel, and the requirement for foreign investors and acquiring companies to sign an 'undertaking' in favour of the IIA. The restrictions continue to apply even after the IIA grant is repaid. It is critical to understand the commercial effects of an IIA grant.

Regarding employment law, the applicability of collective bargaining agreements should be verified, as they may provide covered employees with particular benefits beyond those included in their personal employment agreements. In addition, many such agreements require the employing entity to (at least) consult with the union or employees' council prior to any change of control transaction. Other employment-related matters to be aware of include:

- the potential classification of consultants as employees (if claimed by a consultant);
- the requirement to conduct pre-termination hearings for employees (following the provision of prior written notice a minimum number of days before the hearing date, unless a longer – but not shorter – period is agreed contractually);
- specific laws relating to overtime payments and their applicability to senior positions; and
- an array of social benefits and severance pay rules.

VII OUTLOOK

Israel does not have a central supervision regime for foreign investments, and the bulk of existing FDI regulation is sector dependent. At the same time, certain legislative areas do set out general FDI controls that may apply to a wide range of transactions, such as FDI regulation stemming from national security considerations, restrictions on transactions that entail the purchase of land and requirements arising in state tenders.

In 2020, the Advisory Committee for National Security Affairs in Foreign Investments was established as a centralised mechanism to advise regulators of various sectors on transactions that may give rise to national security considerations.

The Advisory Committee has been in operation for about two years and, according to its report, has examined a significant (but undisclosed) number of potential foreign investments. It is expected that future major foreign investments in Israel will be subject to its scrutiny, especially considering the increasing involvement of foreign entities in infrastructure and public utilities projects. It is hoped that the exact nature of the relationship between the Advisory Committee and the sectoral regulators, as well as the Advisory Committee's range of considerations, will be clarified in the near future based on cumulative experience.

FDI-related requirements, such as Israeli nationality requirements or restrictions on ownership transfers, may also be found in agreements between the state and private entities, as well as in the terms of government permits and licences. Naturally, directives of this nature cannot always be predicted or detected through reference to legislation or public sources. The process of identifying these requirements must be included in an acquiring company's due diligence efforts.

In 2021, the Knesset passed the Regulatory Principles Law. It aims to promote smart regulation policies in Israel, enabling the reduction of any excesses within the regulatory burden and giving weight to the costs of complying with regulations and the implications for advancing the economy and society. This Law stipulates that regulation will generally be determined on the basis of customary international standards or on regulatory requirements already implemented in developed countries with significant markets.[48] In addition, the new legislation provides for establishing a unified regulation database, which may simplify proficiency and, subsequently, compliance with Israeli investment regulations.[49]

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Endnotes

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2 https://finder.startupnationcentral.org/snc-2022-report#:~:text=Seed%20investments%20in%20Israeli%20startups,have%20yet%20to%20be%20published.
3 According to a Bank of Israel document available at https://www.boi.org.il/boi_files/Statistics/peilut.pdf.
4 Pursuant to Section 3(a) of the DCL, a corporation may be declared a defence corporation even if most of its activity is not security activity but if the security activity it does carry out is of significant security importance.
5 DCL, Section 3(b).
6 ibid., Section 5(a).
7 ibid., Section 6(b)(a) and Section 6(2)(b)–(c).
8 ibid., Section 6(5)(a).
9 ibid., Section 6(3)(a).
10 Defence Export Control Law of 2007 (DECL), Section 2.
11 DECL, Sections 3(1), 15(a)(2) and 28(d).
12 ibid., Section 2.
13 Import and Export Order (Oversight of Export of Dual-Use Goods, Services, and Technologies) of 2006, Section 3(a).
14 Law for the Prevention of Distribution and Financing of Weapons of Mass Destruction of 2018, Section 5(a).
15 Mandatory Tenders Law of 1992 (Tenders Law), Section 3(b).
16 id.
17 Mandatory Tenders Regulations (Duty of Industrial Cooperation) of 2007 (Industrial Cooperation Regulations), Section 3. The requirement also applies to a continuation contract following an original contract that was valued at US$5 million, if the value of the continuation contract exceeds US$500,000, made within five years of the original engagement.
18 id.
19 ibid., Section 6. Foreign corporations can fulfil their reciprocal purchase obligations through direct purchases, such as using an Israeli subcontractor to complete the project, or through indirect reciprocal purchases, such as from domestic industries that are not part of the specific project but rather for purposes such as exportation, investments and service purchases. In 2022 alone, new reciprocal purchase obligations were registered in the amount of US$1.4 billion following transactions with foreign suppliers by the Israeli government (the Industrial Cooperation Authority: 2022 annual summary, March 2023).
20 As of 2029, Israel will no longer be permitted to include a reciprocal purchase obligation condition in transactions involving any entities or transaction types that are covered by the Government Procurement Agreement (GPA) (Ministry of the Economy and Industry: 'Reciprocal Purchase Terms under the GPA Treaty' (May 2019)).
21 Mandatory Tenders Regulations (Preference for Israeli Products) of 1995 (Made in Israel Regulations), Section 3. A similar requirement is set out regarding municipalities under the Municipalities (Tenders) Regulations, 1987.
22 The obligation to obtain the requisite approval before transfers of means of control in entities that are subject to an Essential Interests Order is imposed on both the transferor and the transferee.
23 Essential Interests Orders have been published thus far in the fields of security, aviation and petroleum.
24 For example, requirements regarding Israeli nationality are set as conditions for the issuance of certain cable broadcasting and news production licences. See Telecommunications (Telecommunications and Broadcast) Law of 1982, Sections 6h2, 6t2.
25 An 'essential service provider' order may be issued by the Prime Minister and the Minister of Communication with government approval; the order may establish that the communications service is an essential service for national security considerations, is required for the adequate provision of services to the public or is needed for government policy considerations, including competition.
26 See Ministry of Energy website at https://www.gov.il/en/departments/news/press_070121 and https://www.gov.il/en/departments/news/press_300522 (last accessed 31 August 2022).
27 Petroleum Regulations (Principles of Action for Petroleum Exploration and Production at Sea) of 2016, Section 11.
28 Natural Gas Economy Law of 2002, Section 8.
29 ibid., Section 17.
30 Knesset Research and Information Center, Electricity Market Overview, 2022.
31 Electricity Market Law of 1996, Section 3(b).
32 Licences required for conduction, distribution or system management activities are held almost exclusively by the Israel Electric Company and Noga Ltd, the new system management entity (see Knesset Research and Information Center, Analysis of Application of Electricity Market Reform, 2021).
33 It is worth mentioning that the Licensing of the Occupation of Payment Service and Payment Initiation Law, 2023 was recently published and will take effect one year from its publication. This law is set to apply somewhat different regulations regarding the aspects discussed herein concerning the provision of payment services, which may overlap with financial asset services (for example, managing payment accounts or issuing and acquiring payment methods). Under this law, regulatory supervision over entities providing such services will be transferred from the Capital Market, Insurance and Savings Authority to the Israel Securities Authority.
34 The specific permit required depends on the size of the investment as a percentage of total holdings and on the rights accompanying the investment.
35 Defined as an insurer holding an Israeli insurer licence or a foreign insurer licence according to the statute's provisions as well as provident funds.
36 Financial Services (Insurance) Supervision Law of 1981, Section 32(a).
37 Policy for Controlling Institutional Entities, Ministry of Finance – Capital Market, Insurance and Savings Authority, 12 February 2014.
38 Banking Law (Licensing) of 1981 (Banking Licensing Law), Section 34(a).

39 Banking Licensing Law, Section 34(b).
40 Bank of Israel – Supervisor of Banks, Criteria and General Terms for an Applicant for a Permit to Control and [for a Permit to] Hold a Means of Control in a Banking Corporation, 11 July 2013, Section 3.2.4.
41 Banking Licensing Law, Section 6(6).
42 Bank of Israel – Supervisor of Banks, Criteria and General Terms for an Applicant for a Permit to Control and Hold a Means of Control in a Processing Company and Credit Card Company, 29 May 2018.
43 As introduced in a 2005 amendment to the Law for the Encouragement of Capital Investments of 1959 (the Investment Law).
44 As introduced in a 2011 amendment to the Investment Law.
45 As introduced in a 2017 amendment to the Investment Law.
46 Economic Competition Regulations (Registration, Publication and Reporting of Transactions), 5764-2004, Section 9(2).
47 For the purposes of this threshold, a monopoly is defined as an entity that holds a market share exceeding 50 per cent in any defined market, even if it is irrelevant to the transaction.
48 Regulatory Principles Law of 2021, Section 2(4).
49 ibid., Section 37(a).

Chapter 13

Italy

Gian Luca Zampa and Ermelinda Spinelli[1]

Summary

I OVERVIEW

The regime currently applicable to foreign investments in Italy – the Golden Power (GP) regime – was established by Law Decree No. 21 of 2012 (and converted into law and subsequently amended and supplemented by various implementing regulations enacted by the government).

The GP regime empowers the Prime Minister's Office (PMO) to review and, if necessary, impose specific conditions or recommendations or veto transactions or corporate resolutions concerning business activities or assets, or both, that qualify as 'strategic'.

The screening of foreign investments by the PMO is akin to a mandatory pre-merger filing mechanism. Provided that the relevant investment falls within the scope of application of the GP regime, filing is mandatory irrespective of the size of the parties (in terms of turnover or market share) or of the size or value of the transaction. If a mandatory filing is not made, the PMO may review the transaction *ex officio* (and sanctions for failure to notify may also apply).

Originally, the GP regime was applicable only to strategic assets and activities in the defence and national security sectors, as well as to strategic assets in the telecommunications, energy and transport sectors (essentially infrastructure assets). Over time, the scope of application of the GP regime was progressively extended to cover high-tech sectors and certain assets and activities concerning 5G, as well as all the sectors listed in Article 4, Paragraph 1 of Regulation (EU) 452/2019, including, inter alia, water, food, finance, insurance, healthcare, raw materials, logistics, artificial intelligence, big data and data processing.

To the extent that an investment falls within one of the relevant sectors, it may trigger an obligation to make a filing to the PMO, provided that relevant subjective criteria are also met. Although investments in the defence sector or the national security sector are subject to scrutiny irrespective of whether the investor is an EU (including Italian) or non-EU entity, investments in the other relevant sectors were previously reportable only if made by non-EU entities.[2] Notably, however, during the covid-19 pandemic, a temporary regime was enacted through Law Decree No. 23 of 2020 (the Liquidity Decree), greatly expanding the scope of application of the standard GP regime, including to EU investors (see below). The temporary regime ceased to apply on 31 December 2022 and a new permanent regime entered into force from 1 January 2023 (formalising most of the temporary regime).

The GP regime is a stand-alone regime separate from merger control.

Following the covid-19 pandemic, the recent geopolitical crisis and the expansion of the GP regime, the number of transactions reviewed by the PMO has increased significantly compared with previous years. Substantive scrutiny tends to be particularly intense regarding investments in sectors such as 5G, healthcare, semiconductors and high tech, especially when involving certain categories of non-EU investors.

II YEAR IN REVIEW

On 1 January 2023, a new permanent regime entered into force. This replaced the previous temporary regime that was established by the Liquidity Decree on 9 April 2020 during the peak of the covid-19 pandemic and significantly expanded the scope of application of the GP regime. Pursuant to the new permanent regime, the duty to notify under the GP rules applies:

- to EU (including Italian) and non-EU investors, in cases of direct or indirect acquisitions of a sole or joint controlling interest (from 1 January 2023, the list of relevant sectors has been slightly reduced for EU investors); and
- to non-EU investors only, in the case of direct or indirect acquisitions of non-controlling minority stakes (acquisition of shareholdings of at least 10 per cent or 10 per cent of the voting rights, and when the thresholds of 15 per cent, 20 per cent, 25 per cent and 50 per cent are exceeded), provided that the value of the investment exceeds €1 million.

Prior to the introduction of these revised regimes, investment in strategic sectors other than security and national defence would trigger a filing only if carried out by non-EU investors acquiring, directly or indirectly, a controlling interest in the target. (Note that minority acquisitions and acquisitions in the security and national defence sectors by EU acquirers (including Italians) have always been subject to a notification requirement.)

The rules regarding the 5G sector were materially changed in March 2022 and now also apply to EU entities.

The legislative changes of the past three years have caused a significant increase in the number of transactions reviewed by the PMO. This has also been a consequence of certain ambiguities in very broadly worded legislation, which, in practice, has led to the submission of many precautionary notifications (for the sake of legal certainty), essentially aimed at avoiding the potential imposition of fines for failure to file. According to statistics, approximately 54 per cent of the notifications submitted in 2022 resulted in a declaration of non-applicability of the GP legislation, although a number of non-applicability decisions reveal an inconsistent approach that, if anything, further exacerbates the uncertainties surrounding the jurisdictional scope of the GP regime.

In addition, the covid-19 pandemic and the recent geopolitical crisis (and their consequences for industrial supply chains) seem to have increased the level of scrutiny of foreign investments by the PMO. In fact, since April 2021, according to public sources, the PMO exerted its veto right at least six times against Chinese acquirers and at least two times against a Russian acquirer.

III FOREIGN INVESTMENT REGIME

i Policy

The review carried out by the Italian government is based on a number of 'objective and non-discriminatory criteria', but there is ultimately a very broad discretion in the area of policy. The ultimate legal test that the PMO applies is that the transaction under scrutiny should not 'entail a threat of serious prejudice' to the essential national interests in any of the relevant sectors.

The PMO applies the test by carrying out an assessment based on different elements, including:

- the economic and financial ability of the investor;
- the features of the investor's industrial project; and
- the ability to ensure a regular supply of the relevant product or service.

In performing this assessment, the PMO considers any link between the investor and any foreign country in terms of whether it recognises the principles of democracy and rule of law, abides by international law or has behaved negatively towards the international community, or has relations with criminal or terrorist organisations or with persons connected to them.

The GP rules also contain a reciprocity principle, establishing that a non-EU investor is allowed to invest in an Italian company on the same terms and subject to the same conditions as would be applicable to an Italian investor intending to acquire shares or assets relating to an undertaking in the country of the foreign investor. In other words, non-EU investors seeking to purchase shares or assets relating to a strategic undertaking are permitted to do so only if their country allows Italian citizens and companies to be stakeholders of undertakings in the corresponding country and broadly subject to the same conditions. This principle is set out in accordance with the international agreements signed by the Italian government or by the European Union; it does not apply, however, to citizens or companies of non-EU or non-European Economic Area (EEA) Member States with which Italy has special bilateral conventions in place for the mutual protection and promotion of investments.

On the basis of the above considerations, the PMO can perform the following:

- clear the transaction unconditionally;
- clear the transaction subject to remedies or conditions; or
- prohibit the transaction.

It is also possible for the PMO to clear a transaction unconditionally, with 'soft' (i.e., non-legally binding) recommendations.

The majority of notified transactions are cleared unconditionally or are considered not to fall within the scope of the foreign direct investment rules, and prohibition decisions are rare, although they increased in the past year. According to public sources, only three transactions were formally blocked by the government between 2012 (when the GP regime entered in force) and April 2021, whereas at least eight prohibition decisions have been taken since then.

Conversely, decisions clearing transactions subject to remedies or conditions are more frequent. The legislative framework does not provide a list of the types or nature of remedies (conditions or remedies) that the PMO may impose. The PMO retains a very wide discretion in this regard and is at liberty to impose conditions or remedies irrespective of whether the parties have offered them. PMO decisions are not public, however, and there is no official database of the PMO's previous decisions that provides a full description of the commitments imposed. Therefore, there is limited visibility of such decisions. To date, we are aware only of conditions or remedies in relation to the target business (i.e., no conditions or remedies have been imposed in relation to the activities carried out by the purchaser pre-transaction). Conditions or remedies are typically behavioural and are generally aimed at protecting the retention in Italy of certain activities (e.g., manufacturing and research and development (R&D)) or ensuring continued investment in the target entity, among other things. However, remedies are typically quite straightforward and can include the following:

- a requirement to retain facilities – and, in particular, R&D and production plants – in Italy;
- measures to ensure maintenance of economic and financial equilibrium;
- measures to ensure compliance with existing contracts with public bodies and strategic (private) companies (including in terms of quality);
- undertakings to maintain existing cooperation or commitments in relation to Italian and European public institutions; and
- an obligation to inform the PMO of proposed transfers of intellectual property rights.

Increasingly, the PMO also focuses on maintenance of employee numbers in certain strategic functions (typically R&D).

As mentioned previously, remedies do not need to be proposed by the undertakings concerned; these are imposed unilaterally by the PMO in its final decision. The latter will normally require monitoring activities to be carried out by the competent administration or by an ad hoc committee to verify compliance with its remedies. Fines can be imposed in the event of non-compliance, although we are not aware of any precedents in this regard.

ii Laws and regulations

The GP regime is a multi-layered regime. The principal legislation is Law Decree No. 21/2012 (the Law Decree), as incorporated into law by Law No. 56/2012. Originally, this legislation covered the defence and national security, telecommunications, and energy and transport sectors. The Law Decree has been amended several times over the years, in particular to extend the scope of application of the GP regime to include:

- 'sectors of high technological intensity' (October 2017);
- assets and relationships concerning 5G networks and related technologies (March 2019); and
- all sectors listed in Article 4, Paragraph 1 of Regulation (EU) No. 2019/452 (April 2020).

In March 2022, in response to the current geopolitical crisis, Law Decree No. 21 of 21 March 2022[3] (Law Decree No. 21/2022) materially amended the Law Decree by, inter alia, formalising provisions of the temporary regime introduced under the Liquidity Decree of 2020 and by expanding the rules applicable to the 5G sector.

The GP regime set out in the Law Decree is complemented by a number of governmental decrees, in particular:

- the Decree of the President of the Council of the Ministers No. 108/2014, which identifies relevant strategic assets in the defence and national security sectors. Procedural rules applicable to review of transactions in this sector are laid down in the Decree of the President of the Republic No. 35/2014;
- the Decree of the President of the Council of the Ministers No. 180/2020 (DPCM 180/2020), which identifies the networks and facilities as well as the assets and relations of strategic importance in the energy, transport and communication sectors. Procedural rules applicable to the review of transactions in these sectors are laid down in the Decree of the President of the Republic No. 86/2014; and
- the Decree of the President of the Council of the Ministers No. 179/2020 (DPCM 179/2020), which is aimed at defining more precisely which assets and relations are of national interest in the sectors referred to in Regulation (EU) No. 2019/452 on the control of foreign direct investments in the European Union. These include critical infrastructure, technologies, inputs and strategic economic activities in the following sectors: energy; water; health; storage, access and control of data and sensitive information; electoral infrastructure; financial, including credit and insurance; financial market infrastructure; artificial intelligence; robotics; semiconductors; cybersecurity; nanotechnologies and biotechnologies; non-military aerospace infrastructure and technologies; supply of inputs (including in the steel industry) and agrifood; dual-use products; and freedom and pluralism of the media.

iii Scope

The jurisdictional test for the application of the GP regime is based on whether the target carries out certain strategic activities or holds certain strategic assets as listed in the GP implementing regulations and also on the identity of the investor. Once it has been determined that the GP regime applies, the transaction must be reported by the purchaser and (as a consequence of the amendments introduced by Law Decree No. 21/2022) also by the target, at least in principle. The seller may also submit a notification.

Certain acts undertaken by the entity holding the relevant assets (see below) should be notified to the government. These acts may also be non-transactional in nature (e.g., transfer abroad of the company's registered office). In these cases, a notification obligation is triggered as regards the entity holding the relevant assets only. Conversely, for transactional acts, the notification obligation is triggered as regards both the purchaser and the seller.

In the defence and national security sectors, to the extent that they concern any strategic assets or activities, the seller is under an obligation to file with the PMO notification of the adoption of resolutions, acts or transactions of the shareholders or governing bodies of the company that have as its object:

- the merger or spin-off of the company;
- the transfer of the company, of a company branch or of subsidiaries;
- the transfer abroad of the company's registered office;
- the change of the company object in the by-laws;
- the dissolution of the company;
- the transfer of assets or, more generally, of rights *in rem* or rights of use, or imposing constraints on the use of tangible or intangible assets (including where the company is subject to insolvency proceedings);
- the amendment of clauses in the articles of association pursuant to Article 2351, Paragraph 3 of the Italian Civil Code, which provides for limitations or staggering of voting rights with reference to a single party holding several shares; or
- the amendment of clauses in the articles of association introduced pursuant to Article 3, Paragraph 1 of Legislative Decree No. 332 of 31 May 1994.

Importantly, in addition to the seller's filing obligation (and, in principle, that of the target), in the defence and national security sectors, the investor has a corresponding obligation to file with the government notification of the acquisition of either a controlling or a non-controlling interest – irrespective of whether the investor is an EU or non-EU entity. In particular, a filing is required in the event that, as a result of the acquisition, the investor holds an interest greater than the 3 per cent for listed companies or 5 per cent for non-listed companies. A separate filing obligation will be triggered if the shareholding is subsequently increased and the thresholds of 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent or 50 per cent are exceeded.

In the energy, transport and communications sectors, to the extent that they concern any strategic assets, as identified by the DPCM 180/2020, or as listed in Article 4a, Paragraph 1 of Regulation (EU) No. 2019/452 as relevant pursuant to the provisions of DPCM 179/2020, the seller is under an obligation to file the adoption of resolutions, acts or transactions of the shareholders or governing bodies of the company that has the following as its object:

- the change of ownership, control, availability or destination of the relevant assets;
- the merger or spin-off of the company;
- the transfer abroad of the company's registered office;
- the change of the company object in the by-laws;
- the dissolution of the company;
- the amendment of any clauses in the articles of association adopted pursuant to Article 2351, Paragraph 3 of the Civil Code (which provides for the right to limit voting rights to a maximum number of shares held by a single party or to arrange for them to be staggered); and
- the transfer of the company or branches thereof in which the relevant assets are included or the assignment of the same as a guarantee.

In these sectors, the standard regime provides for a parallel filing obligation on the part of the purchaser, although, in contrast to the defence and national security sectors, this applies only to non-EU investors and only to the extent that a controlling interest is acquired. Control is defined as the ability to exert a decisive influence over the undertaking, which may occur through veto rights at board level.

In addition, under the transitory regime that was introduced in response to the covid-19 pandemic and that became permanent – with some edits – on 1 January 2023:

- EU investors are also under an obligation to notify the acquisition of a controlling interest; and
- non-EU investors are obliged to file notification of the acquisition of minority shareholdings of at least 10 per cent of the share capital or of the voting rights of a strategic company (and when the thresholds of 15 per cent, 20 per cent, 25 per cent and 50 per cent are exceeded), provided that the value of the investment exceeds €1 million.

It is important to underline that following the Law Decree No. 21/2022 amendment both the investor and the target company are obliged to submit a joint filing. Alternatively, the investor must provide evidence to the PMO that it has shared notice of the filing with the target company.

The 5G sector was radically changed by the Law Decree No. 21/2022 amendment, which introduced a new obligation for the acquirer to send to the PMO a detailed annual plan regarding the acquisition of goods and services for the design, realisation, maintenance and management of strategically relevant activities in the 5G sector (regardless of whether the contracts or agreements are entered into with non-EU providers).

Notably, intra-group reorganisations in all the above sectors are also subject to a notification obligation, provided that the relevant objective and subjective criteria are met. Law Decree No. 21/2022 also stipulates that mere incorporation of a 'newco' that will be active in sensitive sectors may be in itself be subject to a notification requirement.

The GP regime does not provide a specific definition of the terms 'foreign investment' or 'foreign investor', and the only relevant distinction under the GP rules is between EU/EEA and non-EU/EEA investors. The following are considered non-EU investors:

- any natural or legal person that does not have its residence, domicile, registered or administrative office or main place of business within a Member State of the EU or the EEA or is not otherwise established there; and

- any natural or legal person that does have its residence, domicile, registered or administrative office or main place of business within a Member State of the EU or the EEA or is otherwise established there but is controlled, either directly or indirectly, by a natural or legal person as defined under poiont (a).

Note that if, despite appearing to satisfy the above-mentioned EU or EEA investor requirements, there is an indication that this was merely arranged by the investor to avoid the GP regime, the investor would be considered a non-EU investor.

iv Voluntary screening

Voluntary screening is not applicable. To the extent that the transaction is caught by the GP regime, filing is mandatory.

That said, for completeness, please note that in September 2022 a (non-mandatory) pre-notification procedure came into effect. Through the pre-notification, any interested company can submit to the Italian government a 'project of transaction', which has to outline the main features of a particular transaction based on the information and documents available as at the date of its filing.

Within 30 calendar days of filing the pre-notification, the PMO shall provide its feedback. Based on the applicable legislation, the possible outcomes are the following:

- the transaction does not fall within the scope of application of the Italian FDI rules (therefore no filing will be due);
- the transaction falls within the scope of application of the Italian FDI rules and the PMO asks for a full filing; and
- the transaction falls within the scope of application of the Italian FDI rules; however, it is held that no special powers will have to be exercised by the Italian government, so no full filing is requested (simplified clearance).

v Procedures

Provided that the transaction is caught by the GP regime, notification to the PMO is mandatory. There is no filing fee. Proceedings can be started by the Italian government *ex officio* when a filing has been omitted. The sanctions provided for failure to notify (or for failure to comply with the imposed measures) are very high, ranging from a maximum of twice the value of the transaction to a minimum of 1 per cent of the undertakings' turnover. A 10-calendar-day filing deadline is applicable. The triggering event is different between seller and purchaser: for the seller, the 10 days begin from the date of signing or from the resolution authorising signing (although this deadline seems not to have been enforced strictly to date) and from closing for the acquirer, but, typically, a joint filing is submitted within 10 calendar days of signing. There is no formal pre-notification process.

There is no standstill obligation, at least not from the purchaser's perspective. However, until clearance or expiry of the deadline for the government's review, the purchaser cannot exercise voting rights acquired as a result of the transaction. All acts, including resolutions, adopted or made prior to the clearance or contrary to the veto or imposed measures are null and void. From the seller's perspective, the relevant acts or resolutions concerning strategic assets cannot be enacted prior to clearance or expiry of the applicable deadline.

For transactions concerning the national security and defence, energy, telecommunications and transport sectors, as well as those listed in Article 4, Paragraph 1 of Regulation (EU) 2019/452, there are 45 calendar days for review (calculated from the filing date). If no decision is reached within this time, the transaction is deemed authorised. The 45-day term may be suspended in the case of requests for information issued by the PMO to the parties (until a response is received and for a maximum of 10 calendar days) and to third parties (until a response is received and for a maximum of 20 calendar days). Therefore, since these two suspensions may be consecutive, the maximum term for review is 75 calendar days In relation to the 5G sector, the review period may last up to 30 calendar days (calculated from the filing date). If no decision is reached within this term, the transaction is deemed authorised. The 30-day term may be extended by up to 20 calendar days (in the event of risks to the integrity of networks and their data) and further extended (only once) for 20 calendar days in particularly complex cases. The 30-day term may be suspended in the case of requests for information issued by the PMO to the parties (until a response is received and for a maximum of 10 calendar days) and to third parties (until a response is received and for a maximum of 20 calendar days). Therefore, the maximum possible term for review is 100 calendar days.

Despite some uncertainty as a result of inconsistent implementing regulations, all review terms should be understood as referring to 'calendar' and not 'business' days.

Following entry into force of Regulation (EU) 452/2019 on 11 October 2020, any Member State government receiving foreign investment filings should notify the other EU Member States and the European Commission to allow them to submit non-binding observations or an opinion, respectively. If such observations or opinions are submitted, national review deadlines are suspended for up to 35 calendar days (40 calendar days in the event that the European Commission's opinion follows Member State observations), bringing the overall duration of the review process to approximately 115 days.

However, there is an element of uncertainty relating to the possibility that a notified Member State or the European Commission may request further information from the PMO with a view to providing an observation or opinion. The 35- or 40-day deadline for Member States or the European Commission to provide their observations or opinion is suspended (as are deadlines applicable under national rules) until the information is provided to the Member State or the European Commission, or both. In this scenario, although the PMO is under an obligation to provide the requested additional information 'without undue delay', applicable rules do not provide a specific deadline, and this may lead to unpredictable delays if the information requested from the PMO is owned by another administration, independent agency or public authority.

In addition, to facilitate the review, the PMO may cooperate and exchange information with other public authorities, namely the Bank of Italy; the National Commission for Companies and the Stock Exchange; the Pension Funds Supervisory Commission; the Insurance Supervisory Institute; the Transport Regulatory Authority; the Competition Authority; the Communications Regulatory Authority; and the Regulatory Authority for Energy, Networks and Environment.

Following the review, the PMO can:

- clear the transaction without conditions or remedies;
- clear the transaction with the adoption of remedies; or
- prohibit the proposed acquisition.

It is also possible for the PMO to clear unconditionally with soft (i.e., non-legally binding) recommendations.

The PMO's decisions can be challenged before the Italian administrative courts: the Regional Administrative Court of Lazio in the first instance and the Council of State on appeal.

vi Prohibition and mitigation

Recent changes in legislation have resulted in a very significant increase in the number of transactions notified to the PMO. On the basis of the most recent information available[4] (PMO decisions are not public and there is no official database), the PMO received 608 filings in 2022 (496 in 2021, 342 in 2020, 83 in 2019, 46 in 2018 and 30 in 2017). The outcome of the related proceedings filed in 2022 is shown in the table below.

Outcome of proceedings	Number
Prohibition decisions	4

Outcome of proceedings	Number
Clearance decisions subject to remedies	8
Clearance decisions with soft (i.e., non-legally binding) recommendations	9
Unconditional clearance decisions	164
Inapplicability of the GP regime to the transaction	314
Other	109

Prohibition decisions are rare but have increased recently. Since April 2021, the PMO has exerted its veto right at least six times against Chinese acquirers (inter alia in relation to acquisitions of a robotics company, a manufacturer of drones, two companies active in the semiconductor sector and a company active in agritech) and, on the basis of our knowledge, at least two times against a Russian acquirer (in relation to the acquisition of an Italian leader in the design and production of cylinders and systems for gas storage and of a company active in the cloud services sector).

Clearances subject to conditions or remedies are more frequent. In 2021, 26 proceedings led to the imposition of conditions in the following sectors: national security and defence (24 per cent); 5G technology (42 per cent); and energy, communications (excluding 5G), transport and others (35 per cent).

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

There is no sector in which foreign investment is prohibited per se, but, to the extent that the investment is caught by the GP regime, it is subject to mandatory scrutiny by the PMO.

ii Restricted sectors

As outlined above, sector-specific screening legislation applies to various sectors, including defence, national security, telecommunications and media, 5G, electricity, transport, water, food, finance, insurance, healthcare, raw materials, logistics, artificial intelligence, big data and data processing. Details of this legislation and the competent authorities are described above. There are no sectors where foreign investment is specifically targeted and subject to caps or other requirements such as an obligation to team up with a local partner. For completeness, we note that other sector-specific clearances may be necessary under Italian law (e.g., in the financial or telecommunications sectors), but foreign investors are not specifically targeted.

V TYPICAL TRANSACTIONAL STRUCTURES

As noted in Section III.iii, the test for applicability of the GP regime is whether the company concerned carries out certain strategic activities or holds certain strategic assets or relationships with the Italian jurisdiction.

The legal analysis looks through the corporate and contractual structures that may be adopted, up to the level of the ultimate parent entities holding direct or indirect control over the acquiring vehicles. The key element for assessing jurisdiction and reportability is thus the acquisition of control, whether sole or joint, and which may be direct or indirect. The acquisition of a qualified minority (see above) in an entity having direct or indirect, joint or sole control over strategic assets or activities would also be reportable.

In this context, provided that the relevant objective and subjective criteria are met, the GP regime applies to both direct and indirect investments that are structured as either asset or share deals. No specific rules are set out for takeover bids or portfolio investments, for which the general rules apply. However, for completeness, and as noted already, the legislative changes introduced in Law Decree No. 21/2022 stipulate that mere incorporation of a newco that will be active in sensitive sectors may in itself be subject to a notification requirement if one or more shareholders are non-EU investors and hold a portion of the voting rights or the corporate stock of no less than 10 per cent.

VI OTHER STRATEGIC CONSIDERATIONS

The GP regime and the Italian merger control regime are separate. Nonetheless, it is common to consider obtaining both GP and merger approvals when structuring the transaction or drafting transaction documents, mostly because of the potential standstill-related implications. From a transactional perspective and, in particular, with regard to the position of the acquirer, it is worth noting that neither the GP nor the Italian merger control regime provides for an absolute standstill obligation.

In fact, on the purchaser's side, the GP regime technically allows closing of the transaction to occur before clearance or expiry of the deadline for the government's review, although the purchaser is precluded from exercising the voting rights acquired as a result of the transaction before clearance or expiry of the review deadline. An absolute standstill obligation applies, however, to the seller, with the consequence that a condition precedent relating to clearance of the transaction is often included in transaction documentation.

If a prohibition decision or clearance subject to conditions is adopted following the PMO's review, the parties are obliged to restore the status quo ante or comply with the conditions.

Similarly, the Italian merger control regime allows closing of the transaction to occur even while the review before the national authority is still pending (provided that a timely merger filing has been submitted).

VII OUTLOOK

Since the outbreak of the covid-19 pandemic and the recent geopolitical crisis, the new GP legislation has resulted in a very significant increase in the number of transactions subject to governmental review. This has also led to more prohibition decisions, especially in relation to Russian and Chinese acquirers. More generally, the government in place since October 2022 is taking a more restrictive approach than in the past, in terms of both imposing commitments (including on maintenance of know-how and employment in Italy) and exercising jurisdiction with reference to sectors it had previously excluded (leveraging the wide margin of discretion allowed by the letter of the law).

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Endnotes

1 Gian Luca Zampa and Ermelinda Spinelli are partners at Freshfields Bruckhaus Deringer LLP.
2 As indicated below, rules applicable to EU investors are also applicable to European Economic Area investors.
3 Converted in Law No. 51 of 20 May 2022.
4 PMO's 2020 Report on information policy for security, available in Italian at https://www. sicurezzanazionale.gov.it/sisr.nsf/wp-content/uploads/2021/02/RELAZIONE-ANNUALE-2020.pdf.

Chapter 14

Japan

Kaori Yamada and Hitoshi Nakajima[1]

Summary

I OVERVIEW

Japan's foreign investment regulations are broadly divided into those based on the Foreign Exchange and Foreign Trade Act (the Forex Act) and those based on other individual laws.

Although the Forex Act stipulates that foreign investors are free to make inward foreign direct investments without interference from authorities, it requires prior notification for investments in limited sectors that are considered to be of serious concern from the perspective of Japanese national security and requires *ex post facto* reporting for certain other inward foreign direct investments.

In recent years, with the progress in information technology, cybersecurity-related businesses have had a significant effect on national security. The Forex Act was therefore revised in November 2019 to regulate investments that may impair national security, in light of the trend of tightening foreign investment regulations that had preceded in Europe and the United States. The revised Forex Act has been fully in force since June 2020.

Under the revised Forex Act, the standard for prior notification required for foreign investors to acquire shares in a listed company operating in a designated industry was reduced from 10 per cent to 1 per cent and a prior notification exemption system was introduced.

Foreign investments are also regulated by multiple individual laws. For example, the Radio Act, the Broadcasting Act, the Act on Nippon Telegraph and Telephone Corporation, the Freight Forwarding Business Act, the Aviation Law, the Ship Act and the Mining Act all prohibit foreign investors from acquiring more than a specified percentage of shares in Japanese companies or specific rights (or both) and restrict the entry of foreign investors by uniform regulations that are not subject to screening by the authorities.

II YEAR IN REVIEW

Revisions to the Broadcasting Act and the Radio Act were passed in June 2022 to strengthen restrictions on foreign investments in broadcasting businesses; the new restrictions came into effect in April 2023. The Broadcasting Act and the Radio Act stipulate that, to prevent foreign capital from controlling domestic broadcasting businesses, operators of terrestrial and satellite broadcasting services should keep the ratio of voting rights held by foreign investors below 20 per cent, and that business authorisations and licences can be revoked in the event of a breach. The revised Broadcasting Act and the revised Radio Act require operators to notify every change in the ratio of voting rights held by foreign investors as a result of increased purchases, among other things, and to report regularly to the relevant authority the ratio of voting rights held by foreign investors.

In June 2021, a new Act on the Review and Regulation of the Use of Lands and Buildings Around Important Facilities and Border Islands was passed to regulate land use around self-defence force bases, nuclear power plants and remote border islands to reduce the risk of foreign investors buying land in areas of importance to Japan's security and using it for inappropriate purposes. Under this Act, the state stipulates that an area of approximately 1km around important security facilities (such as self-defence force bases and nuclear power plants, as well as remote border islands) will be designated as watch areas, allowing the Japanese government to investigate land use in these areas and to issue cease-and-desist orders or recommendations relating to acts that interfere with the functioning of important facilities. Particularly important areas around facilities and remote islands will be designated as special watch areas, requiring prior notification for land sales and purchases in these areas. Criminal penalties may also be imposed for failure to comply with the orders or to notify. This Act came into full force in September 2022.

In addition, the Economic Security Promotion Act (Act for the Promotion of Ensuring National Security through Integrated Implementation of Economic Measures) was promulgated in May 2022 to establish a new framework for the stable provision of core infrastructure and will introduce *ex ante* regulations similar to the screening framework under the Forex Act for security-critical infrastructure. Under the Act, operators designated as core infrastructure providers (i.e., operators from among the 14 sectors of electricity, gas, oil, water, railways, freight forwarding, ocean freight, aviation, airports, telecommunications, broadcasting, postal services, finance and credit cards to be further designated if they own critical facilities and there is a high need to ensure the continuity of service provision) are required to submit a plan to the competent minister for review before introducing critical facilities or outsourcing their maintenance and management, etc. The competent minister examines whether, if the plan is implemented, the critical facilities concerned are likely to be used as a means of obstructing the stable provision of services relating to core infrastructure by foreign companies, and if the minister considers that there is a high risk of this, the minister may change or cancel the plan. This framework may become an issue in the future when a foreign company intends to introduce its products in Japan. The relevant provisions will come into force in stages from 2023 onwards.

Furthermore, in response to the designation in the Economic Security Promotion Act of 'specified critical goods', which are subject to support to ensure the stable supply of key infrastructure, the Japanese government has also amended the relevant notification to the effect that, in the pre-closing notification system under the Forex Act, businesses relating to goods designated as specified critical goods (i.e., fertilisers, permanent magnets, machine tools and industrial robots, semiconductors, storage batteries, natural gas, metal mineral products and ship parts) are to be added to core sectors that are of particular security importance among designated sectors requiring pre-closing notification. In addition, metal 3D printer-related businesses have also been added to core sectors, although they are not designated as specified critical goods. The amendments of the relevant notification have been applied since 24 May 2023.

III FOREIGN INVESTMENT REGIME

i Policy

The purpose of the Forex Act is to enable the proper development of foreign transactions and to maintain peace and security both in Japan and in the international community by implementing the minimum necessary management and coordination for foreign transactions, thereby contributing to the sound development of the Japanese economy based on the freedom of foreign exchange, foreign trade and other foreign transactions.

For this management and coordination, when foreign investors intend to make inward foreign direct investments, the Minister of Finance and the minister in charge of the target business require foreign investors to notify them of information about the transaction in advance, to examine whether the transaction will 'impair national security', 'impede the maintenance of public order', 'interfere with the protection of public safety' or have a 'significant adverse effect on the smooth operation of the Japanese economy' (Article 27, Paragraph 3 and Paragraph 1 of the Forex Act).

Additionally, for certain transactions, *ex post* reports are required.

ii Laws and regulations

Foreign investment in Japan is regulated by the Forex Act and its supplementary regulations, ministerial ordinances and notices. There are also industry-specific laws that regulate investments by foreign nationals or set limits to the ratio of shares that may be held by foreign nationals and the ratio for foreign directors, including:

- the Broadcast Act;
- the Radio Act;
- the Civil Aeronautics Act;
- the Consigned Freight Forwarding Business Act;
- the Mining Act;
- the Ship Act;
- the Act on Nippon Telegraph and Telephone Corporation; and
- the Review and Regulation of the Use of Lands and Buildings Act.

Under the Forex Act, the competent authorities are the Minister of Finance, who is responsible for approving all capital transactions and foreign direct investments, excluding trade, and the Minister of Economy, Trade and Industry, who is responsible for authorising trade, services and all trade-related transactions, such as settlements of trade payments and compensation. The Bank of Japan (BOJ) also has an administrative role in accepting notifications in both hard copy and digital format and in compiling statements of balances of payments.

The determination of core sectors, or the designation of sectors deemed to be in the national security interest, falls on the Minister of Finance and relevant ministries. For instance:

- the Prime Minister: security services;
- the Minister of Finance and Prime Minister: central banking;
- the Minister of Interior Affairs and Communications: telecommunications, radio, application and contents providers, and internet service support providers;
- the Minister of Health, Labour and Welfare: pharmaceuticals and water supplies;
- the Minister of Agriculture, Forestry and Fisheries: farming and fishing cooperatives;
- the Minister of Economy, Trade and Industry: weaponry (apart from transportation of weaponry), aircraft, satellites, rockets, mining, oils, leather goods, manufacturing of personal computers, electricity and software production; and
- the Minister of Land, Infrastructure, Transport and Tourism: railways, shipping and freight forwarding.

In keeping with global trends, Japan introduced a series of amendments to the Forex Act between 2019 and 2020 to address mounting concerns over perceived threats to national security.

In August 2019, Japan expanded its list of regulated sectors requiring pre-notification screening to include:

- the manufacturing of computing equipment and related components (including integrated circuits, flash memory storage media and mobile telephones);
- the manufacturing of information processing software; and
- telecommunications services (mobile and fixed lines) and internet support services.

In October 2019, the second amendment took effect, expanding the range of regulated investment activities to include:

- the ownership of voting rights;
- the grant of a public or private company proxy;
- two or more foreign investors that own 10 per cent or more of shares or voting rights in a Japanese listed company entering into a shareholders' agreement; and
- listed Japanese companies that engage in one of the regulated industries cited under the Forex Act.

The third amendment, in June 2020, lowered the threshold for mandatory pre-screening notification of acquisitions in listed Japanese companies that are engaged in designated 'sensitive sectors' (designated for national security reasons) from 10 per cent to 1 per cent. Under the new rule, any foreign investor that contemplates an acquisition of 1 per cent or more of shares or voting rights in Japanese listed companies must now notify the BOJ prior to making the investment. However, to counteract the effects of broadening the screening base of prior notifications, the government introduced two types of exemption (blanket exemptions and regular exemptions, as described below), both designed to minimise disruption to inbound foreign investment and keep the number of review cases manageable.

In addition, in the third amendment, manufacturing of medicines for infectious diseases and manufacturing of highly controlled medical devices were added to the designated sectors requiring pre-notification screening.

In May 2020, the Ministry of Finance announced 'Factors to be considered in authorities' screening of prior notification for Inward Direct Investment and Specified Acquisition under the Foreign Exchange and Foreign Trade Act'.[2]

Furthermore, in May 2023, in line with the Economic Security Promotion Act, Japan added businesses relating to the following industries (as well as metal 3D printer-related businesses) to the designated and core industries requiring pre-notification screening under the Forex Act:

- fertilisers;
- permanent magnets;
- machine tools and industrial robots;
- semiconductors;
- storage batteries;
- natural gas;
- metal mineral products; and
- ship parts.

iii Scope

The Forex Act captures 'inward direct investments' or other types of transactions by a 'foreign investor', including greenfield investments such as establishing a branch, factory or representative office in Japan.

'Foreign investors' are defined as:

- non-resident individuals;
- corporations, partnerships, associations or other entities established in foreign jurisdictions or having their principal offices in foreign countries;
- companies of which at least 50 per cent of voting rights is directly or indirectly held by those listed in point (a) or point (b), above;
- partnerships that run investment businesses or limited investment partnerships or other entities (including foreign unions) of which at least 50 per cent of the investment amount is held by non-residents or at least 50 per cent of the managing members are non-residents; and
- corporations, partnerships, associations or other entities in Japan in which the majority of either the officers (i.e., directors or similar) or the representative officers are non-resident individuals.

'Inward direct investments' by foreign investors captured by the Forex Act are defined as:

- the acquisition of 1 per cent or more of shares or voting rights of listed companies;
- the acquisition of shares or equity of unlisted companies from persons who are not foreign investors;
- the transfer of shares or equity from non-resident individuals to foreign investors (where non-resident individuals acquired such shares or equity after 1 December 1980 while being resident in Japan);
- consent of foreign investors being required for (1) a substantial change of the business purpose of domestic companies (if they are listed companies, this is limited to cases where foreign investors hold at least one-third of the voting rights in those companies), (2) proposals for the appointment of directors or auditors (nomination of the foreign investor itself or its closely related persons) and (3) proposals such as the transfer of the entire business. In the case of item (2) or item (3), if the company in question is a listed company, this is limited to cases where foreign investors hold at least 1 per cent of voting rights in a company;
- establishing a branch, factory or other establishment (excluding a representative office) in Japan, or substantially changing the business type or objectives of a branch, factory or other business office (excluding those businesses engaged in banking, foreign insurance, gas, electricity, certain types of securities, investment management, foreign trusts and fund transfers);
- the lending of money exceeding ¥100 million to domestic corporations for a term exceeding one year, where the total loan principal and the value of bonds issued by domestic corporations to the lending foreign investors exceed 50 per cent of the amount of debt of the domestic corporations;

- succession of businesses by transfer of businesses from resident corporations, absorption-type split and merger (excluding cases in points (a) to (c), above);
- the acquisition of private placement bonds exceeding ¥100 million issued by Japanese corporations where the period until the redemption date is more than one year, and the total loan principal and the value of bonds issued by the domestic corporations to the foreign investor exceed 50 per cent of the amount of debt of the domestic corporation (or corporations);
- the acquisition of investment securities issued by established corporations, such as the BOJ, based on special laws;
- discretionary investments in the shares of listed companies where the actual investment ratio or the ratio of the actual voting rights is 1 per cent or more (in this case, the investment ratio and the ratio of voting rights include those owned by foreign investors who are closely related to the discretionary managers);
- the acceptance of the appointment to represent persons in exercising the voting rights of domestic companies directly held by the persons where the acceptance of appointment falls under item (1) or item (2) and is limited to the cases under items (3), (4) and (5) as follows: (1) acceptance of the appointment to exercise voting rights for listed companies and the ratio of the actual voting rights after the acceptance is 10 per cent or more (in this case, the ratio of voting rights includes those owned by foreign investors who are closely related to the persons accepting the appointment); (2) acceptance of the appointment to exercise voting rights for unlisted companies, which is entrusted by persons other than foreign investors who directly hold the voting rights; (3) where the person to be entrusted is someone other than the company or its officers; (4) where the proposal on which the person to be entrusted intends to exercise voting rights through the acceptance relates to the 'election or removal of directors', 'shortening the term of office of directors', 'amendment of articles of association', 'assignment of businesses', 'dissolution of the company' or 'merger agreements'; and (5) where those who accept the appointment solicit to have themselves exercise the voting rights;
- the acquisition of the right to exercise voting rights where the ratio of the actual voting rights of the acquirer after the acquisition is 1 per cent or more (in this case, the ratio of voting rights includes those owned by foreign investors who are closely related to the acquirer);
- delegating the voting rights of domestic unlisted companies acquired when an individual is a resident to a foreign investor after the individual has become a non-resident (this is limited to the cases under items (3), (4) and (5) of point (k), above); and
- obtaining the consent of other non-resident individuals or corporations that hold the actual voting rights of listed companies in jointly exercising the voting rights of listed companies where the aggregate ratio of the actual voting rights of the acquirer of the consent and the other party is 10 per cent or more (in this case, the ratio of voting rights includes the actual voting rights of foreign investors who are closely related to the acquirer of the consent and the other party).

iv Voluntary screening

Filing is mandatory barring certain exceptions.[3] The Ministry of Finance and other relevant ministries are generally open to voluntary pre-filing consultation if there are any substantive enquiries.

v Procedures

A foreign investor who makes an investment needs to submit either a prior notification before making the investment or an *ex post* report after the foreign investment has been made, unless certain exceptions apply. All notifications are submitted to the BOJ, through which the competent government ministries will be notified. The notifying party is the foreign investor intending to make the acquisition.

Pre-closing notification

If the target of the foreign investment or any of its direct or indirect subsidiaries or joint ventures is engaged in a specified regulated business industry that is deemed sensitive to public order, public safety or national security, a pre-closing notification must be filed with the BOJ. Specified regulated sectors ('designated sectors') that require pre-closing notification include, for example;

- manufacture of goods relating to arms;
- manufacture of goods relating to aircraft;
- manufacture of goods relating to space exploration;
- manufacture of goods relating to nuclear energy;
- repair of machinery for the above-mentioned goods;
- software industry relating to the above-mentioned goods;
- metal mining industry relating to nuclear raw materials;
- manufacture of general purpose goods that can be converted to military use;
- manufacturing, software, natural science laboratories, machine design, commodity and non-destructive testing and other technical services industries possessing technology that can be converted to military use;
- manufacture of pharmaceuticals for infectious diseases (including pharmaceutical intermediates and biological products);
- manufacture of highly controlled medical devices (including accessories and components);
- sectors relating to the stable supply of important mineral resources such as rare earths (e.g., metal mining);
- construction work relating to the management of coastal protection zones and construction work on certain remote port facilities;
- crude oil mining;
- natural gas mining;
- petroleum refining industry;
- integrated circuit manufacturing;
- semiconductor memory media manufacturing;
- optical and magnetic discs and magnetic tapes manufacturing industry;
- the electronic circuit board manufacturing industry;
- part of the electricity, gas, water and sewerage industry;
- part of the telecommunications industry;
- part of the information processing services or internet usage support services industry;
- part of the software industry;
- part of the railway industry;
- part of the warehousing industry; and
- part of petroleum gas filling and petroleum gas storage business; etc.

Of these designated sectors, certain businesses that are considered to be particularly sensitive, such as armoury, aircraft, nuclear power, space development, dual-use technologies, cybersecurity, electricity, gas, telecommunications, water supply, railway services and oil, are categorised as 'core sectors', which tend to be screened particularly carefully. In addition, if the nationality or location of a foreign investor is a country other than Japan and the 163 countries and regions listed in Attached Table 1 of the Order on Inward Direct Investment, or if an Iranian-related person acquires shares in a specific industry, a prior notification is also required. Pre-closing notifications must be filed within six months of the intended closing date and the transaction cannot be implemented for a suspensory period of 30 days after the acceptance of the application by the BOJ. The suspensory waiting period may be shortened to as little as two weeks or, in certain cases, four business days from the acceptance of the application.

The suspensory period may be extended to up to five months if the proposed investment raises national security concerns, requiring further scrutiny by the Custom and Foreign Exchange Advisory Panel. The notification will be reviewed by the relevant ministries. The authority may require hearings, written responses to requests for information or the submission of additional documents, or all of them.

Blanket exemptions

Foreign institutional low-risk investors that comply with the following conditions are exempt from the requirement to notify the transaction before closing:

- investors or closely related persons must not become board members of the target company;
- investors must not propose the transfer or sale of important businesses of the target company to the general shareholders' meeting while they hold a stake in the target company; and
- investors must not access non-public information about the target company's technology that could affect national security.

For example, foreign securities houses, banks, insurance companies, asset management firms, trust companies, registered investment trusts and registered high-frequency traders are eligible for this blanket exemption, provided that they comply with the conditions above. These exemptions for foreign financial institutions are applicable irrespective of the target business sector, including core sectors.

Regular exemptions

Other foreign investors (companies, sovereign wealth funds (SWFs) and public pension funds accredited by the Minister of Finance) can also be eligible for an exemption, provided that they comply with the conditions above. However, foreign investors, including SWFs and public pension funds, seeking exemption from pre-closing reviews for an investment of up to 10 per cent of the shares of a business in a core sector must comply with two additional conditions. Investors must not:

- become members of the target company's committees responsible for making important decisions in business activities; or
- make proposals, in written form, to the executive board of the target company or its board members, requiring their responses or actions, or both, by certain deadlines.

Stock purchases by persons who have been punished for violating the Forex Act and state-owned enterprises (excluding accredited SWFs and public pension funds) are not eligible for the exemption. The accreditation criteria by the Japanese government for SWFs and public pension funds are as follows:

- investment activities concern only economic returns; and
- investment decisions are made independently of their governments.

At present, a total of 891 listed companies qualify as being in 'core' sectors, with about half of approximately 3,979 listed companies operating in 'designated' sectors with national security implications.[4]

Post-closing report

If the following three conditions are met, and the day after a foreign investor underwrites the shares by which the foreign investor's investment ratio or voting rights ratio combined with closely related parties exceed 10 per cent, an *ex post* report is required:

- the nationality or location of a foreign investor is Japan or one of the 163 countries and regions listed in Attached Table 1 of the Order on Inward Direct Investment;
- the business operated by the investee does not include businesses belonging to the designated sectors or the prior notification exemption system has been applied; or
- the foreign investment is not performed by Iranian officials.

A post-closing report must be submitted within 45 days (or within 30 days for certain investments) of closing of the transaction to the BOJ using a prescribed form.[5] The notification form is reasonably detailed, requiring information about the foreign investor, the seller, the proposed transaction and the Japanese target company and its business activities. Unlike the forms of some other countries, no extensive narrative explanations are needed. There is no need to notarise or legalise such forms. Unlike the pre-closing notification, the authorities will neither approve nor reject transactions that have been filed under the post-closing regime. We understand that post-closing reports are used mostly for the purpose of statistical analysis of foreign investments.

If relevant ministers find that a foreign investment is likely to compromise national security, they may order the foreign investor to restructure the transaction or withdraw from the investment. If the foreign investor does not follow the order (or completes the investment without filing a mandatory notification), relevant ministers may order the foreign investor to dispose of all or part of the shares or equity acquired through the investment or take other necessary measures.

Implementing a transaction prior to obtaining clearance may result in criminal penalties for the individuals responsible. The level of penalties varies depending on the details of the infringement, but the maximum penalty is either imprisonment of up to three years or a fine (of up to ¥1 million or three times the amount of the investment), or both.

The Forex Act allows applicants to object to or re-examine the decision issued by the competent minister by filing a petition or requesting a re-examination.[6] Once the petition is accepted, the investor will receive reasonable advance notice for a public hearing to take place. If the investor is still dissatisfied with the outcome, the case may be brought to court.

Implementing a transaction prior to obtaining clearance may result in criminal penalties for the individuals responsible. The level of penalty varies depending on the infringement, but the maximum penalty is either imprisonment of up to three years or a fine (of up to ¥1 million or three times the amount of the investment), or both.

vi Prohibition and mitigation

Neither the review process nor the final decision of the relevant authorities is public information. However, the Ministry of Finance publishes information annually on the number of pre-closing notifications in respect of inward direct investment and specified acquisitions under the Forex Act. The information for 2022 was made public in June 2023.[7] To date, the Japanese government has prohibited only one foreign investment under the Forex Act, when it ordered The Children's Investment Fund (TCI) to cease its planned acquisition of up to 20 per cent of shares in the Japanese electricity supplier J-Power in 2008. Although TCI pledged to abstain from voting on matters that pertain to the operation of nuclear power plants or electricity facilities, the failure to substantiate the pledge with a legally binding commitment gave rise to suspicions that the Fund may exert a degree of influence over J-Power's management to the detriment of energy security. Moreover, as TCI had presented J-Power with numerical targets without means to achieve them to enhance shareholder returns, there were concerns that spending on infrastructure and maintenance may be compromised in an effort to achieve the targets. Following the recommendation from the advisory panel, the government ordered TCI to cease its investment in J-Power, citing potential disruption in energy security. TCI did not appeal the decision.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

There are no sectors in which foreign investment is expressly forbidden.

ii Restricted sectors

Restricted sectors are as follows: broadcasting, radio, telecommunications (Ministry of Internal Affairs), aviation, consigned freight forwarding, domestic shipping (Ministry of Land, Infrastructure, Transport and Tourism) and mining (Ministry of Economy, Trade and Industry).[8]

As mentioned above, businesses within the designated sectors under the Forex Act (e.g., weaponry, aircraft, nuclear facilities, space, dual-use technologies, electricity, gas, telecommunications, water supply, railway, oil, heat supply, broadcasting, public transportation, biological chemicals, security services, agriculture, forestry, fisheries, leather manufacture, air transportation and maritime transportation) are subject to screening by the Minister of Finance and the ministers in charge of each business under the notification system. Individual laws enforce uniform foreign capital regulation that does not depend on screening by the authorities. For example, the Radio Act and the Broadcasting Act stipulate that a person who has a licence for a broadcasting station can refuse to transfer the name of the shareholder list if the voting rights of foreigners are one-fifth or more. In addition, the Aviation Act and the Nippon Telegraph and Telephone Corporation Act stipulate that if the voting rights of foreigners of the target company are one-third or more, the transfer of the name of the shareholder list can be refused.

V TYPICAL TRANSACTIONAL STRUCTURES

i Corporate law residency requirements

Foreign investors can acquire business presence in Japan by establishing an overseas representative office, a branch or a subsidiary. Foreign companies generally set up branches and subsidiaries for conducting business in Japan, as representative offices are not permitted to engage in sales activities. Although branches and subsidiaries require registration with the Legal Affairs Bureau, there is no need to register a representative office, because it does not have legal status under the Companies Act. Although a branch or a subsidiary may be headed by a non-resident representative director, for branch offices, at least one of the representatives must be a Japanese resident. The legal requirement for subsidiaries to have at least one representative to be domiciled in Japan has been removed; in practice, the post is usually occupied by a Japanese resident at the outset to receive funds and open corporate bank accounts.

ii Rules pertaining to takeover bids by foreign companies

Although there are detailed takeover rules for non-residents (e.g., takeover bids by non-residents are accepted as long as an individual who either is domiciled in Japan or has an office in the country is appointed as agent of the offeror to undertake related administrative tasks, such as filing notifications), in principle, both foreign and Japanese companies abide by the same rules.

However, if the takeover bid is structured as a share acquisition, the transaction will be subject to notification rules and capital restrictions under the Forex Act and other commercial laws.

iii Notable differences between an asset purchase and share purchase by a foreign investor

A share purchase is the transfer of shares from the shareholder to the purchaser conferring control of the company to the purchaser. An asset or business acquisition, however, involves purchasing the seller's business, in whole or in part. Although a share purchase has certain advantages, such as the automatic transfer of existing permits and licences, the drawback is the assumption of off balance sheet liabilities for the acquirer. Respectively, although cherry-picking is possible in asset purchases, the transfer of permits and licences is not automatic, and the foreign investor may be obliged to convene a general meeting of shareholders to acquire a business in its entirety or a business that is integral to the overall operation.

Under foreign investment rules, an acquisition of 1 per cent or more of shares in a listed company operating in a designated sector or one or more shares in an unlisted company operating in a designated sector would constitute direct inward investment and be subject to pre-closing notification rules. Acquisition of a business by a foreign investor from an entity resident in Japan (limited to corporations) would also be subject to the same rules.

For share acquisitions, inward direct investments are exempt from pre-closing notification rules unless the transaction involves companies active in national security-related sectors. The same exemption from prior notification also applies to share acquisitions in unlisted companies for acquisitions of up to 10 per cent of voting rights (including those by closely related parties). However, the transactions would still be subject to post-closing notifications. No such exemptions are available in asset or business acquisitions.

iv Possibility of entering into joint ventures (with or without a domestic partner)

A sole foreign investor that establishes subsidiaries or other forms of legal entities in Japan may face substantial cost and associated risks. The investor must develop its own network of contacts with government agencies and, depending on the nature of the business, it may not be permitted to take a solo stake in domestic businesses. In such cases, the foreign investor may consider joining forces with a domestic partner.

Joint ventures enable partners to pool shared resources such as technology, patents, brands, infrastructure, knowledge and networks. Japanese laws and regulations (particularly those governing foreign investment) may be avoided. Joint venture partners can also leverage their respective customer bases. By taking advantage of these arrangements, foreign investors can ensure that their projects will get off to a quick start. However, the risks associated with joint ventures include potential breach of sensitive commercial information, the inevitable conflict of interest between the partners and the added layer of complexity within the reporting structure, causing bottlenecks in decision-making.

v Other corporate structures for ownership

A foreign, non-resident investor may also take a direct stake in voluntary partnerships whose membership includes Japanese companies. For example, a foreign investor may join forces with another partner to engage in cooperative partnerships or participate in syndicate funds. In terms of reporting obligations, for share acquisitions that constitute inward direct investment, the revised Forex Act stipulates that investment limited liability partnerships must submit pre- and post-notifications under their respective names (not under the names of its members). To qualify for exemption, the partnership must be a specified partnership (that is, a voluntary partnership, investment limited liability partnership or other type of partnership established under foreign laws and regulations). The partnership must also have a foreign investment ratio of more than 50 per cent or have a foreign investor as a general partner for executing day-to-day business.

Partnerships outside the scope of specified partnership are exempt from pre-closing notification obligations under the Forex Act for both the partnership and its members. Conversely, investment funds formed under foreign laws and regulations sharing the same properties as specified partnerships are subject to pre-closing notification rules. Foreign funds that are outside the scope of specified partnership but that satisfy the definition of corporate entity, or other bodies established under foreign laws and regulations, also carry the same reporting obligations.

VI OTHER STRATEGIC CONSIDERATIONS

The formalistic nature of Japanese foreign exchange filing obligations means that mandatory filings may be avoided if foreign entities are able to alter their transaction structure to avoid making direct share acquisitions in Japanese entities. However, as regulators evaluate each transaction in substantive terms, making obvious superficial changes to the transaction structure may result in regulatory intervention. Foreign investors are therefore advised to avoid making deliberate changes to corporate or transaction structures as a way of circumventing mandatory filing obligations if the substance of the deal is likely to attract regulatory scrutiny in the country.

Japan's foreign investment regime is a stand-alone regime that is separate from the merger control regime.

VII OUTLOOK

In June 2023, public comments were opened on draft decrees concerning two of the measures under the Economic Security Promotion Act, which was passed in May 2022. The Act provides for four measures: (1) ensuring the stable supply of critical goods: (2) ensuring the stable provision of key infrastructure services; (3) supporting the development of cutting-edge critical technologies; and (4) keeping patent applications private. Of these, measures (1) and (3) came into force in August 2022. The draft decree in June 2023 therefore covers measures (2) and (4).

Measure (2) is to prevent the risk of external interference with the stable provision of services relating to core infrastructure and to establish a mechanism for the competent minister to examine in advance the installation, maintenance and management of critical facilities to be commissioned by operators in 14 core infrastructure sectors.

Measure (4) is to introduce a mechanism to designate preservation and withhold publication of patent applications through examination and restrictions on foreign applications in order to prevent patent applications for inventions sensitive to national security from being published or leaked.

In preparation for the full enforcement of the Act in the first half of 2024, ministerial ordinances and guidelines, etc., that provide details of measures (2) and (4) will be formulated by the autumn of 2023.

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Endnotes

1 Kaori Yamada is a partner and Hitoshi Nakajima is an associate at Freshfields Bruckhaus Deringer.
2 Refer to the following link for the English version of the publication: https://www.mof.go.jp/english/ international_policy/fdi/gaitamehou_20200508.htm.
3 Examples include changing business purpose if the purpose is not one specified as a designated sector requiring pre-notification.
4 On the basis of the 'List of Applicability of Prior Notification of Inward Direct Investment, etc. on Japanese Listed Companies, under the Foreign Exchange and Foreign Trade Act', published by the Ministry of Finance on 19 May 2023: https://www.mof.go.jp/policy/international_policy/gaitame_kawase/press_release/20230519.html.
5 The relevant forms can be downloaded from BOJ's website page on procedures relating to the Forex Act (pre-closing notification: https://www.boj.or.jp/about/services/tame/t-down.htm/; post-closing reports: https://www.boj.or.jp/about/services/tame/t-redown2014.htm/).
6 Forex Act, Chapter VII-2.
7 https://www.mof.go.jp/policy/international_policy/gaitame_kawase/press_release/20230623.pdf.
8 List of ministers with jurisdiction over designated sectors (boj.or.jp).

Chapter 15

Mexico

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Summary

I OVERVIEW

As the United States' second largest trading partner,[2] accounting for approximately 15.2 per cent of total trade with that country as at April 2023,[3] and a member of the 2020 United States–Mexico–Canada Agreement (USMCA) (successor to the 1994 North America Free Trade Agreement (NAFTA)), Mexico has become a huge host for foreign investment in most sectors of its economy, from manufacturing to the import and export of goods. By way of example, Mexico is currently the seventh major car manufacturing country in the world, an achievement that would not be possible without the participation of foreign automotive manufacturers in Mexico.[4] The Mexican foreign investment regime is mainly regulated by the Mexican Constitution, international foreign investment treaties and the 1993 Foreign Investments Law and its implementing regulations.

II YEAR IN REVIEW

Although Mexico has historically been open to foreign investment and, in fact, is the 11th largest country for foreign direct investment as a host country[5] and the eighth most appealing emerging market for investors,[6] the 2018–2024 government administration has taken a restrictive approach towards foreign investments, mainly in the energy sector, in line with an agenda focusing on the protection and use of natural resources as a national priority.

Although this approach by the government has, in practice, limited the scope for foreign competitors in the investment landscape, foreign direct investment in Mexico nevertheless increased by 48 per cent, totalling US$18.6 billion, during the first quarter of 2023.[7]

III FOREIGN INVESTMENT REGIME

i Policy

Since 1 December 2018, Mexico has been governed by a left-of-centre government, which has sought to review many of the legal developments of the past. Although the main aim of this governmental approach is the fight against corruption and the impunity enjoyed by its beneficiaries, some policy changes have been disconcerting and have generated a number of questions about their soundness in relation to enhancing economic growth. This situation has been compounded by the fact that the government has given little or no economic assistance to companies undergoing hardship as a result of the covid-19 pandemic. As a case in point, the government recently enacted rules and regulations that, if and when applied, would result in an imbalance favouring government companies such as Pemex and CFE in the production and commercialisation of petrol and gasoline and of electricity, respectively. These rules and regulations have been controversial and, in fact, their application has been suspended in some instances by the judicial branch of government. Likewise, the current government has been promoting development hubs for well-being in the Isthmus of Tehuantepec and the construction of a rail network connecting the main cities and touristic areas of that area and the Yucatan Peninsula. As such, and to promote foreign investment, in May and June 2023, the Mexican government issued decrees to promote investments within this area, including several international bidding processes to grant concessions for two years for the use and exploitation and also the possibility for the sale of the hubs located in the Isthmus of Tehuantepec, with the granting of specific tax and administrative benefits to investors.

ii Laws and regulations

Generally speaking, the Constitution, international investment treaties and the 1993 Foreign Investments Law and its regulations (as amended) (collectively, the FIL) are the main legal instruments regulating foreign investment in Mexico.

In the international sphere, foreign investments in Mexico and Mexican investments abroad are regulated and protected through bilateral or multinational foreign investment treaties. These treaties provide rules and provisions aimed at protecting, promoting and strengthening investments between Mexico and other countries and also providing for dispute resolution mechanisms between investors and states through, for example, investor-state arbitration procedures.

In the national sphere, the Constitution stipulates economically 'strategic' activities, in which foreign investment is restricted or, in some specific cases, not permitted at all (see Section IV). The FIL regulates the specifics regarding what is understood as foreign investment, the rules and requirements for foreign investors to participate in the corporate capital of Mexican entities, and the activities capped or the maximum percentage foreign investors can hold.

In addition, there are other laws, regulations and general provisions issued by government agencies regarding foreign investments. The Secretariat of Economy is the main government agency in charge of the application, fulfilment and observance of these legal instruments, and to implement the FIL and ensure compliance with the foreign investment regime the Secretariat has sub-agencies that specialise in the field of foreign investments, such as:

- the Directorate General of Foreign Investment (DGIE);
- the National Register of Foreign Investment (RNIE); and
- the National Foreign Investment Commission (CNIE).

iii Scope

The FIL defines foreign investment as the participation (of any percentage) by foreign investors in the corporate capital of Mexican entities, investments in Mexican companies where the majority interest is composed of foreign capital, or the participation by foreign investors in the activities and sectors stipulated in the FIL. A foreign investor is defined as any individual or entity of any nationality other than Mexican, including foreign entities with no legal independent existence.

In addition to establishing the framework for foreign investments, the FIL gives a brief description of each relevant business sector, any remaining restrictions with respect to foreign investments and the extent of those restrictions. Regardless, as a general rule, all foreign investments must be reported to the RNIE, which is administered by the DGIE.

iv Voluntary screening

Subject to sector-specific requirements (see Section IV), a foreign investor must obtain approval from the CNIE for a participation greater than 49 per cent in:

- port services for vessels performing inland navigation transactions;
- navigation companies dedicated to the exploitation of vessels;
- entities that are concessionaires or holders of permits for public service airports;
- private education services;
- legal services; and
- construction, operation and exploitation of railways.

Further to the above, foreign investors require authorisation from the CNIE whenever they acquire, directly or indirectly, equity of a company whose assets are above the amount fixed each year by the CNIE (currently, around 22.7 billion Mexican pesos or approximately US$1 billion).[8] The time taken by the CNIE to authorise transactions of this kind may vary but is not usually considered a significant obstacle. The CNIE may demand certain undertakings from a foreign investor in relation to employment, technology transfer or investment as conditions of granting authorisation.

v Procedures

The first protection is the standard of treatment afforded to foreign investment. There are three major standards: minimum, national and 'most-favoured nation'.

The minimum standard requires Mexico to provide foreign investors with fair and equitable treatment in accordance with international standards, including full protection. The national standard implies the absence of discrimination based on nationality. Thus, foreign investors must enjoy treatment no less favourable than that afforded to Mexican investors in similar circumstances. Finally, the most-favoured-nation standard implies that Mexico must grant the investor at least the same treatment as that provided to other investors in similar circumstances.

An additional protection relates to specific rules safeguarding against expropriation or equivalent measures. Expropriation, nationalisation and equivalent measures (e.g., regulatory seizures) should take place only when they are required for reasons of public purpose, on a non-discriminatory basis, observing due process and through fair market value indemnification relating to the foreign investment.

Another fundamental protection is the prohibition of performance requirements. Mexico may not condition the receipt or continued receipt of an advantage or incentive on the meeting of any requirements. There is also the principle of free transfer of currency, which has already been mentioned briefly. Foreign investors may freely transfer, without delay and in hard currency, profits, dividends and any type of cash stemming from or involving their investment.

Finally, bilateral investment treaties (BITs) usually prohibit the requirement that Mexican nationals occupy senior management positions.

Mexico has entered into a substantial network of 31 BITs, with Argentina, Australia, Bahrain, Belarus, Brazil, China, Cuba, Hong Kong, Iceland, Kuwait, Panama, Singapore, South Korea, Switzerland, Trinidad and Tobago, Turkey, Uruguay, the United Arab Emirates and 16 EU Member States (Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Netherlands, Portugal, Slovakia, Spain, Sweden and the United Kingdom). Mexico has also signed a BIT with Haiti, although this is not currently in force,[9] and it is currently negotiating BITs with the Dominican Republic, Malaysia, Russia and Saudi Arabia.

Although certain differences may exist in BITs depending on specific negotiated terms, the content of these treaties is, by and large, homogeneous. The BITs generally include two sections: investment protection principles and dispute resolution mechanisms.

The most relevant of these for the business environment in Mexico is the new USMCA (or T-MEC), which came into effect on 1 July 2020, superseding the well-known NAFTA and including provisions regulating investment between Mexico, Canada and the United States. The USMCA treaty accounts for one of the largest free trade regions in the world in terms of volume of trade, and grants most-favoured-nation treatment to US and Canadian investors. The USMCA includes activities and sectors that were not relevant or in existence when the former NAFTA agreement entered into force on 1 January 1994, such as telecommunications, internet commerce and minimum labour standards.

In addition to the USMCA, Mexico currently has several free trade agreements (FTAs) with investment clauses with countries such as Bolivia, Chile, Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Japan and Nicaragua, and additional FTAs with Peru and the nations of Central America are pending ratification. Mexico also became the first country to ratify the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP-11), which was signed by Australia, Brunei, Canada, Chile, Japan, Mexico, New Zealand, Peru, Singapore and Vietnam on 8 March 2018, creating unprecedented access to the economies of these countries for the signatories. This agreement came into full effect on 30 December 2018, with ratification by Canada, Japan, Mexico, New Zealand, Singapore and Australia.

Both BITs and FTAs generally grant foreign investors the right to bring an action against the Mexican state in the event of a breach or an alleged breach of specified provisions. The dispute resolution mechanism in the BITs and the FTAs is arbitration, usually preceded by negotiation. The investors will usually select a three-member arbitration tribunal. The goal is to ensure equal, impartial and non-discriminatory treatment for the foreign investor and the host state, which would be difficult to ensure by resorting to the courts of either country. Although the USMCA largely retained certain dispute resolution mechanisms from NAFTA, Canada–Mexico disputes are now governed by theTPP-11 rather than the USMCA.

vi Prohibition and mitigation

The FIL provides that the RNIE is not a public register. As such, and when applicable, the information received by the RNIE is considered to be reserved or confidential in terms of the General Law of Transparency and Access to Public Information. Hence, no individual information may be disclosed but, rather, only general and consolidated information; for example, it can be determined from the RNIE that foreign direct investment in Mexico increased by 48 per cent, totalling US$18.6 billion, during the first quarter of 2023.[10] The United States and Spain were the main countries of origin of the foreign direct investment reported during the first quarter of 2023, with a joint amount of US$10.18 billion, representing more than half of the foreign direct investment reported in this period.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

While, in general, foreign investors may participate in Mexican projects without major restrictions (such as being allowed to participate directly in the corporate capital of Mexican legal entities; purchase and sell assets; manufacture, import and export products; and open and operate establishments or businesses of any legal nature), some limitations apply to certain economically strategic activities, in which foreign investment is restricted or, in some specific cases, not permitted at all.

The Constitution actually provides that certain strategic activities are to be expressly reserved to the state and to be undertaken exclusively, either in whole or in part. The following strategic activities are reserved to the state:

- the postal service, telegraphy and radio-telegraphy;
- radioactive minerals and nuclear energy;
- the control of the national electricity system along with the transmission and distribution of electricity;
- the production of coinage and the printing of money;
- hydrocarbons;
- basic petrochemicals; and
- the control, supervision and oversight of airports, ports and heliports.

Past reforms have resulted in the transmission of electricity and the exploration and extraction of hydrocarbons being significantly deregulated and, although still restricted, both foreign and domestic private entities are now allowed to participate in these activities to a certain extent, using a type of profit or production sharing mechanism with the state oil company, Pemex. However, the López Obrador administration has been systematically pushing to regulate again and to essentially nationalise hydrocarbon and energy production within the country, on the grounds that the state-owned companies now have to face unfair levels of competition from foreign entities, which have benefited excessively from the past reforms.

ii Restricted sectors

As mentioned briefly in Section III, certain economic activities are capped at a certain percentage of foreign investment participation. These restrictions are found in the FIL and include the following:

- a limit of up to 10 per cent foreign investment in the case of cooperative companies for production; and
- a limit of up to 49 per cent foreign investment in:
  - explosives and firearm-related industries;

- printing and publishing of national circulation newspapers;
- equity representing land for cattle or agricultural use;
- freshwater fishing and fishing within the coastal and economic exclusion zone;
- port administration;
- port piloting services of vessels to perform inland navigation transactions;
- shipping companies dedicated to the commercial exploitation of vessels for inland navigation and coastal shipping, except for cruises;
- supply of fuels and lubricants for vessels, aircraft and railway equipment;
- broadcasting; and
- domestic air transportation and specialised air transportation.

The limits on foreign investment participation in the above-mentioned economic activities may not be exceeded directly or through trusts, contracts, partnership or by-law agreements, pyramid schemes or other mechanisms granting any control or higher participation than that established. However, neutral investment, which is a sort of preferred non-participatory financial investment equity that is not characterised as foreign investment subject to the FIL, has made equity participation possible despite these restrictions.

Neutral investment allows economic rights but very limited corporate rights, and it will not grant the foreign investor control over the corresponding company or trust. Therefore, foreign investors may participate in Mexican companies or in trusts through a special class of stock authorised by the Secretariat of Economy, which is not taken into account in determining the percentage of foreign investment in the company's capital stock.

As discussed in Section III, in general terms and subject to the restrictions previously addressed, foreign investors receive the same treatment as domestic investors when acquiring or becoming involved in restricted areas, including in matters such as antitrust approvals, where the focus would be on the nature of the transaction and not necessarily on the nationality of the parties involved. The only difference for foreign investors is the percentage of ownership interest that they can hold, either directly or indirectly.

For information purposes, the Mexican government relies on statistics provided by the RNIE, which monitors foreign investment, collects statistics and carries out surveys relating to foreign investment in the country. Specific information about investors and investments is not generally available to the public, except for the statistical data available through general publications or aggregate data available on the RNIE website.[11] Some recent modifications to the General Law of Commercial Companies require information about equity structure to be made available to the federal government.

All foreign investors and Mexican companies with foreign participation in their ownership are subject to registration. Upon registration with the RNIE, periodic reporting obligations arise; failure to comply with these obligations may trigger the imposition of fines. Regarding real estate, there are no restrictions for Mexican commercial companies seeking to acquire urban real property, even if non-Mexican equity holders participate in the capital stock as minority or majority stakeholders. However, companies may acquire rural property only to the extent that it is necessary for the fulfilment of their corporate purpose.

In no event may these corporations acquire real property dedicated to agricultural, cattle or forestry activities of an area larger than the thresholds established for these activities.

Furthermore, acquiring property in a restricted zone (which covers an area creating a belt around the country, 100 kilometres wide in the border regions and 50 kilometres wide along the coast) requires, inter alia, Mexican companies to include a *Calvo* clause in their corporate by-laws. A *Calvo* clause is a requirement for foreign shareholders to consider themselves Mexican nationals in respect of the company's property and includes an express agreement not to invoke the protection of their own government, under penalty of forfeiting their property in benefit of the Mexican nation.

Mexican companies with a *Calvo* clause included in their by-laws are authorised to acquire real estate located in the restricted zone for non-residential purposes and have beneficiary rights over real estate located within the restricted zone for residential purposes. If acquiring real estate for non-residential purposes, a corporation is required to register the acquisition with the Ministry of Foreign Affairs.

Foreign citizens cannot acquire real estate within the restricted zone by any means, regardless of the purpose for which the property would be acquired; however, they can hold beneficiary rights in trusts established for the purpose of holding ownership of the relevant real estate, subject to securing a prior authorisation from the Ministry of Foreign Affairs.

V TYPICAL TRANSACTIONAL STRUCTURES

Investors seeking to establish a presence in Mexico have a variety of options to achieve that goal. They can do so directly by means of a representative office or a branch office or by choosing to establish a local corporate entity.

Representative offices are an easy and inexpensive way of exploring the Mexican market. This type of vehicle allows an interested investor to test the waters and lay the groundwork for a more substantive incursion into business activities in the country. Through a representative office, the interested party may distribute information about its business, as well as advertising materials, but is not allowed to perform business transactions (understood to be income generating activities).

Because the condition precedent for establishing a representative office is that the activities performed by the entity do not generate income, such offices are not subject to significant tax obligations and liabilities (except withholding taxes if the entity employs local people).

For certain industry sectors, such as banking and insurance, establishing a representative office in Mexico requires prior approval from the agencies regulating those sectors (the National Securities and Banking Commission, for example) and in some cases will also require authorisation from the CNIE.

Branch offices, like representative offices, do not require the foreign investor to incorporate a new legal entity in Mexico. They allow investors to act in Mexico and conduct business transactions directly through their corporate entities incorporated abroad. However, investors seeking to open a branch office must first obtain authorisation from the Secretariat of Economy and subsequently register with the relevant office of the Public Registry of Property and Commerce for the location in which the office will be operational. Once authorised, a branch office may perform any business activity that is not otherwise limited to the Mexican state, to Mexican nationals or to Mexican companies.

Notably, in the absence of a separate corporate presence in Mexico, liability is directly attributable to the foreign corporation because there is no 'buffer' or corporate veil between it and the local business operations.

As an alternative to representative and branch offices, investors may choose to incorporate a new commercial entity in the country, existing independently from the original foreign corporation. In most cases, this will shield the investor from direct liability for operations carried out in Mexico by the new local vehicle.

There are two main commercial structures that shield the foreign investor from liability: the corporation (SA) and the limited liability company (SRL).

Both the SA and the SRL are allowed to enter into the same business activities and markets and are treated equally for tax purposes.[12]

In terms of protecting investors from liability, both corporate vehicles are limited liability entities, with stakeholders liable only for an amount up to the value of their respective contributions into the company and not for the operations of the company itself (for which the company is liable). This protection has certain limits, of course, as illegal activities may pierce the corporate veil.

i General principles applicable to SAs and SRLs

A few general principles of law govern the liability of the directors and officers of both types of companies, except in the case of publicly held corporations, for which more detailed regulations exist. Generally, directors must act reasonably, in the best interests of their principals, and must recuse themselves from the discussion and approval of transactions if these present a potential conflict of interest.

Minority investors in an SA have more statutory rights than those in an SRL. For instance, equity holders in an SA representing 25 per cent or more of the capital stock may challenge and suspend the adoption of any resolution and have a statutory right to postpone a shareholders' meeting for a legal term of three days if they need additional information about the matter to be discussed at the meeting.

Equity holders in both an SRL and an SA may be subject to involuntary separation on certain specific and limited grounds. The grounds for separation for an SRL are provided in the General Law of Commercial Companies and include scenarios such as an equity holder using the company for its own private business, infringing the by-laws or applicable laws, fraud against the company or insolvency. In the case of SAs, the grounds for separation may be set out in the by-laws, given that the General Law of Commercial Companies does not provide a set list of scenarios.

Capital calls, capital redemption, transformation, spin-offs and mergers, and capital contributions, both in kind and in cash, follow the same principles in both companies.

One difference is that the by-laws of an SRL may require additional contributions from its partners. In both cases, the by-laws may provide for negative controls and special provisions for the adoption of decisions.

In SRLs, any partner in the company has a statutory right to withdraw from the company when management is conferred to a person who is not a partner or whenever management is delegated to a non-partner. In practice, this statutory right is difficult to enforce as it is unclear how the equity should be redeemed by the company and at what value. The shareholders of SAs and SAPIs (see below) are not granted separation rights in this instance.

The rules for SAs were amended in 2014 to make the vehicle more appealing for private equity investors and for joint ventures. In general, the shareholders of an SA may agree upon the following:

- the rights and obligations of purchase and sale options;
- stock sales and all other acts relating to first refusal rights;
- agreements to exercise voting rights (i.e., shareholders' agreements); and
- agreements for the sale of their shares in a public offer.

Notwithstanding the foregoing, the provisions regarding minority rights must always be taken into consideration.

There is also a sub-type of the SA called an investment promotion corporation (SAPI), which is a corporate vehicle created to foster the establishment of joint ventures and private equity investments. Although it is regulated by the Securities Exchange Law, it is not a publicly traded entity and is not subject to the governance rules for publicly traded entities. However, the shareholders of an SAPI may choose to apply the director's liability regime that applies to listed companies.

Currently, there are no really marked differences between the regulation of SAs and SAPIs. However, unlike SAPIs, SAs are not allowed to include restrictions stripping shareholders of the right to receive dividends or otherwise limiting their economic rights, and they are not allowed to purchase their own shares, so from this perspective SAPIs are more flexible than traditional SAs. In contrast, SAPIs may not be governed by a sole director, whereas SAs may choose to have a sole director instead of a board.

ii Asset purchases and share purchases

Before we enter into substantive discussions of the main differences between asset purchases and share purchases and their advantages and disadvantages, note that there are no restrictions on transferring capital or profits into or out of Mexico. Additionally, there are no currency restrictions in Mexico and repatriation of funds is unlimited. As such, foreign investors are allowed to purchase assets or ownership interests in Mexican entities directly, subject only to the restrictions described in Section II.

From a business perspective, the easiest and most common method used to acquire an existing business in Mexico is through the purchase of all, or a controlling interest in, the equity representing the corporate capital of the target entity, on the understanding that SAs, SAPIs and SRLs must at all times have at least two partners or shareholders, although one of these may have a nominal participation.

The transfer of shares (in the case of an SA) is usually done by a simple endorsement in property of the stock certificates representing the corporate capital or (in the case of an SRL) through the transfer, by means of an assignment agreement, of the equity quotas representing the corporate capital of the entity, although it is important to remember that the General Law for Commercial Companies provides that the partners holding the majority of the equity interest of an SRL must approve the transaction (this threshold may be set higher in the corresponding by-laws of the target entity). The transfer of shares or equity quotas must be registered in the corresponding shareholders' or partners' registry book. The business terms (e.g., purchase price, representations and warranties, and conditions precedent) are usually documented through a US-style stock purchase agreement, which will contain customary terms and conditions, as well as representations and warranties concerning the underlying business being purchased.

Some of the main advantages of acquiring an existing business through a stock purchase are as follows:

- the business suffers no discernible changes to its operations as of the moment of the acquisition, notwithstanding that the new owners may at a later point make any adjustments they find convenient;
- the transaction is fairly simple and straightforward, with minimum corporate requirements other than the endorsement or assignment of the share certificates or quotas representing ownership of the entity; and
- apart from any sector-specific requirements, there is no need for further action once the transfer of the ownership interest is effected, as the assets, operating permits, employees and tax benefits, among others, are generally not subject to additional transfer requirements.

One of the downsides of effecting a stock purchase is that all liabilities accrued by the company prior to the purchase remain with the acquired entity (including tax and employment liabilities). Although these liabilities may be covered and transferred to the seller in the stock purchase agreement, claims can result in a judicial process that could prove costly and burdensome to the buyer.

However, the purchase of assets is a safe choice when a buyer wants to limit liability resulting from accrued obligations generated by the target entity prior to purchase.

By its very nature, the purchase of assets is a more burdensome and complicated transaction and thus more expensive than a 'traditional' stock purchase, as the buyer and seller must agree on exactly what assets and liabilities (e.g., accounts payable, debts and current employees) are to be transferred to the purchasing entity. Both from a business perspective and as a tax obligation, each transferred item must be identified in the asset purchase agreement, with the price allocation for each item.

Additionally, when purchasing assets, there is an actual transfer of ownership of each asset. As such, the acquiring entity may need to carry out certain formalities, such as obtaining permits to operate or use the assets, and may have to hire or transfer employees into the purchasing entity. Furthermore, the transfer of certain assets may be subject to certain formalities, such as specific government authorisations (e.g., registrations on machinery) that may be required to identify the elements involved in the transfer (e.g., notarial deeds, government authorisations and consents from third parties). If these assets are subject to lien, security or collateral, or an attachment, or the selling entity is a depository for items of this kind, there could be restrictions on their transfer. In addition, if the acquisition of assets would result in the transfer of a majority of the business of seller, the transfer may be considered the acquisition of an ongoing business and taxed as such.

One of the main advantages of pursuing an asset purchase over a stock purchase is that the purchaser will have certainty that it is not acquiring contingent liabilities or undisclosed liabilities from the selling entity. However, parties should note that if the authorities find that the purchaser acquired an ongoing concern, the purchaser could be jointly liable for unpaid taxes and, in the event of a finding that the employees who were transferred form part of the deal, also liable for employment obligations.

The primary disadvantage of an asset purchase is the tax cost for the parties (depending on whether or not the assets were already highly depreciated) and the labour implications. From an employment standpoint, the seller may be required to transfer personnel to the entity designated by the purchaser, which might involve severance costs for the selling entity, with immediate hiring by the buyer. However, it is not unheard of for the parties to agree that the purchaser will assume all the corresponding obligations of the seller as a 'substitute employer', subrogating to all the seller's obligations with respect to seniority, benefits, amounts owed on account of salaries and similar labour-related obligations.

There are certain delays in implementing an asset transfer insofar as it might be necessary to obtain new registrations and authorisations for the activity, product or service (e.g., environmental authorisations, official standards and registrations for imports). Not only may all this represent a delay but it could also entail costs that would need to be properly evaluated.

iii Taxation

In brief, a company's tax obligations depend on whether it is considered a Mexican resident for tax purposes or whether the foreign company is considered to have a permanent establishment in Mexico. For a legal entity to be considered a Mexican resident for tax purposes, its main office or effective management must be established within the country.

Non-resident companies are considered to have a permanent establishment in Mexico when their businesses are carried out completely or partially in Mexico. This is done either through any offices, branches or agencies located in Mexico or through an agent (with dependent or independent status in some cases) with the power to enter into agreements on the company's behalf. However, this does not apply in the case of truly independent agents.

Tax laws and treaties further regulate the creation of permanent establishments and the status of non-residents when they may be deemed to be doing business in Mexico.

VI OTHER STRATEGIC CONSIDERATIONS

As part of the high-level analysis to be undertaken before investing in Mexico, investors should consider the country's well-documented social and economic circumstances.

Although most investors should not expect to face overly cumbersome regulatory hurdles when investing in the more traditional aspects of the Mexican economy, there are several hot button issues that may be a headache for even the most well-intentioned and seasoned foreign investor.

Because government corruption is notorious, particularly in the infrastructure sector, entities involved in this area of business should exercise additional caution (e.g., strict compliance with their domestic anti-corruption laws and strict compliance with local laws and anti-money laundering standards) to avoid being faced with judicial review and sanctioning procedures. Furthermore, businesses engaged in activities that require constant and close work with the government should be particularly careful to ensure independence and fair dealing with government officials. While maintaining good relationships with government officials is important, there are strict guidelines prohibiting gifts or 'privileges' for officials.

Finally, because of anti-corruption regulations and the possibility of accidentally getting involved in illegal activities, it is important for foreign investors to be careful when choosing local counsel for any and all business undertakings.

VII OUTLOOK

Although certain decisions adopted at the federal level by the López Obrador-led administration have created shockwaves throughout the Mexican economy (such as cancelling the multibillion-dollar Mexico City International Airport and restricting the entry of private companies into the electricity market), to date, the markets have generally responded with a sensible level of scepticism about any potential long-term damage to the economy and to Mexico's place as one of the leading foreign investment host countries in the region. Mexico and its leading automotive industry have a huge opportunity for growth, given the nearshoring effect associated with the geopolitical changes and the needed change in the supply chain moving from China to other less politically risky host countries. In that sense, because of the deep economic ties and interdependency between the three North American countries (reiterated and strengthened through the USMCA), increased investment and growth are expected in the region as a whole. The federal elections to be held in June 2024 are anticipated to be very competitive and important. The most important elections in Mexico's recent history involve the fight not only for the presidency but also for nine governorships, the entire Federal Congress, 30 State Congresses and very significant municipalities in the entire country. The impact will be significant due to the expected evaluation by the electorate of the accrued performance of Mr López Obrador and Morena, the party he belongs to.

Furthermore, there are other instruments, such as the Trans-Pacific Partnership Agreement, that are also expected to support a substantial expansion of foreign investment into Mexico and the opening of new markets.

In that context, the revamped Mexico–European Union FTA that was successfully renegotiated during 2018, with the final agreement concluded in 2020, is currently undergoing pending signatures for the final ratification. The new FTA is expected to come into force in late 2023 and includes standards that will make our country a more attractive place in which to invest and work. Mexico and the more industrialised nations are becoming increasingly homogeneous and, accordingly, the most significant aspects of this agreement include cutting-edge anti-corruption provisions and a conflict resolution process explicitly tailored to cases of corruption.

As mentioned, there are significant developments that prove Mexico's leadership in sectors as relevant as the automotive industry, highlighting the February 2023 confirmation by Tesla of a US$5 billion investment of a new plant in Monterrey, Mexico and by ZF Group of a €240 million investment of a new plant in Querétaro, Mexico.

Finally, it is worth highlighting that during May 2023 the Mexican Congress approved a significant reform to the mining legal framework, with various components that may be challenging for investors. Federal courts have been requested to review the validity of the congressional approval process and the substantive merits, which may result in some of those changes being struck down. The important thing here is the test of having an independent judiciary, which is a key element for an attractive host country for foreign investment.

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Endnotes

1 Juan Francisco Torres Landa Ruffo and Federico De Noriega Olea are partners, Andrea López de la Campa is counsel and István Nagy Barcelata is an associate at Hogan Lovells.
2 April 2023 figures show that Mexico is the United States' second largest trading partner, after Canada (Mexico accounts for 15.2 per cent of total trade, Canada 15.4 per cent and China 11.1 per cent).
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7 https://www.gob.mx/se/prensa/mas-de-18-mil-millones-de-dolares-de-inversion-extranjera-directa-de-enero-a-marzo-de-2023#:~:text=La%20Secretar%C3%ADa%20de%20Econom%C3%ADa%20informa,registr%C3%B3%2012%20mil%20553%20mdd. (Amount not considering the extraordinary investments by the Televisa-Univision merger and the restructure of Aeromexico).
8 As updated by the CNIE in June 2022.
9 https://investmentpolicy.unctad.org/international-investment-agreements/countries/136/mexico?type=bits.
10 https://www.gob.mx/se/prensa/mas-de-18-mil-millones-de-dolares-de-inversion-extranjera-directa-de-enero-a-marzo-de-2023#:~:text=La%20Secretar%C3%ADa%20de%20Econom%C3%ADa%20informa,registr%C3%B3%2012%20mil%20553%20mdd. (Amount not considering the extraordinary investments by the Televisa-Univision merger and the restructure of Aeromexico).
11 The RNIE is accessible through the website of the Secretariat of Economy (in Spanish) at https://www.gob.mx/se/acciones-y-programas/competitividad-y-normatividad-inversion-extranjera-directa?state=published and https://rnie.economia.gob.mx/RNIE/faces/inicio.xhtml.
12 Investors are advised to refer to local counsel to discuss any tax effects in their local jurisdiction.

Chapter 16

Netherlands

Paul van den Berg and Max Immerzeel[1]

Summary

I OVERVIEW

Foreign direct investment (FDI) is considered a vital part of the Dutch economy, and the country, despite the relatively modest size of its gross domestic product (GDP), remains one of the largest recipients and sources of FDI. An important factor in achieving strong levels of FDI is the attractive investment climate, with advantages such as the country's physical and digital infrastructure, educated labour force, stable government and policy, tax regime, efficient labour market, and investments in innovation and technology. Against this backdrop, the Netherlands has long advocated the importance of free trade and its open market economy. Restrictive measures were long considered undesired and unnecessary, particularly as a large proportion of critical infrastructure in the Netherlands (such as railways, ports and energy transmission networks) is state-owned. The (attempted) acquisitions of several Dutch corporate 'crown jewels' by foreign acquirers at the beginning of this century, such as ABN AMRO and several telecommunications and utilities companies, have led to a public debate about the need for legislative protection. Subsequently, the government acknowledged that several key pillars of the Dutch economy, for example as a result of globalisation and digitisation, have become prone to interference by foreign states and geopolitical tensions. In particular, in 2019, the government recognised that the shift in the financial and economic world order was one of 11 'dominant threats' to national security. In short, the government considered that the combination of technological progress and geopolitical shifts left the open economy more vulnerable to abuse by foreign actors.

In past decades, the limited foreign investment laws that were applicable were relatively liberal and applied to specific sectors only. In 2012, the Dutch government enacted screening legislation that captured investments in liquefied natural gas (LNG) production facilities (the Gas Act) and electricity generation facilities with a nominal capacity of 250 megawatts (the Electricity Act). In 2014, screening legislation applicable to investments in healthcare providers was introduced (the Healthcare Market Regulation Act). In the 2017 cabinet coalition agreement, the government announced that it would introduce 'specific protection' for 'vital sectors' by means of a 'careful analysis of national security risks'.[2] Since October 2020, the acquisition of 'predominant control' of 'telecommunications parties' has been subject to a notification to the Minister of Economic Affairs and Climate (the Minister) (the Telecommunications Act). These notification requirements apply regardless of the nationality of the investor.

On 1 June 2023, the National Security Investment Act (the Vifo Act) entered into force. In addition to the sector-specific screening legislation, the Vifo Act introduced a broader national security investment screening policy covering investments in vital suppliers (energy, transport hubs and financial institutions), sensitive technology (notably military and dual-use goods) and managers of corporate campuses. The Minister has the power to retroactively review transactions taking effect after 8 September 2020 and before the entry into force of the Vifo Act.

In October 2020, the Minister established the Investment Screening Office, which advises on notifications under the aforementioned sector-specific legislation and the envisaged Vifo Act, except for healthcare-related notifications, which are dealt with by the Dutch Healthcare Authority (NZa). The Investment Screening Office acts as coordinator of notifications, reviews notifications and advises the Minister on remedies and other measures to mitigate potential risks. It is also entrusted with the enforcement of the EU FDI Regulation,[3] which entered into force in October 2020, and the implementation of sanctions against Russian and Belarussian nationals and organisations as a result of Russia's invasion of Ukraine in February 2022. In our experience, the Investment Screening Office is cooperative and responsive when dealing with questions on jurisdictional matters.

In addition, the government has intervened in attempted acquisitions of Dutch companies by using more informal powers. Examples include political opposition to the attempted acquisitions of PostNL by Bpost, Unilever by KraftHeinz, AkzoNobel by PPG and KPN by America Móvil. In June 2020, the government made a financial investment in SMART Photonics, a Dutch scale-up developer of photonic chips, to ensure that the company would not be controlled by foreign investors. As evidenced by the intervention, acquisitions involving companies of national interest can be subject to political scrutiny beyond any formal legislative powers.

II YEAR IN REVIEW

A key development of the past year concerned the introduction of the Vifo Act, which is described in more detail below (see Section III.iii).

The introduction of additional public interest and FDI screening mechanisms forms part of a broader trend at European Union level, as well as in other EU Member States, where governments are opting for stricter investment review policies to protect national interests. Decisional practice of the Investment Screening Office is not made public, so limited information is available about specific investments that were approved, resulted in in-depth review or were conditionally approved. The Investment Screening Office published information on its decisional practice under the telecommunications regime that has been in place since October 2020, which revealed that seven transactions were notified without any prohibition decisions. In the period January 2021 to July 2022, the NZa cleared 281 transactions. We are not aware of any prohibition decisions issued by the NZa.

III FOREIGN INVESTMENT REGIME

i Policy

The Netherlands has historically taken a very liberal stance towards foreign investments, but its policy has become somewhat more stringent during recent years, as evidenced by the introduction of the aforementioned investment screening legislation.

Although the appraisal criteria differ under the various legislative instruments (as further described below), the government's assessment of foreign investment is based on the following principles:

- the appraisal focuses on the protection of national security and public interest only; that is, not any economic or competition concerns, which are monitored by the Dutch competition authority (the Netherlands Authority for Consumers and Markets (ACM));
- the notification requirements apply regardless of the nationality of the acquirer(s); that is, there are no exemptions for domestic or EU-based investors;
- the consequences for the investment climate must remain as limited as possible, namely minimum legal uncertainty, a clear and narrow scope of application, low administrative burdens and short decision periods; and
- the competent authorities should be held accountable for decisions, for example through judicial review and in parliament.

ii Laws and regulations

Notifications made under the Healthcare Market Regulation Act are reviewed by the NZa, which is an autonomous administrative authority within the Dutch Ministry of Health, Welfare and Sport. Under this legislation, the NZa may consult the ACM for matters relating to competition law, for example whether a notified transaction constitutes a change of control within the meaning of Dutch and EU competition law. In addition, a legislative proposal is pending, which envisages the test currently performed by the NZa being transferred to the ACM (in addition to the standard merger control test that the ACM already performs). However, the legislative proposal has not yet been adopted by Parliament.

Notifications made under the telecommunications, energy and (forthcoming) national security regimes are reviewed by the Minister, with assistance from the Investment Screening Office. The Minister may consult other government authorities (such as the intelligence services or the ACM) if necessary. The European Commission and other EU

Member States can be consulted under the EU FDI Regulation. However, the substantive review of any notified transaction remains at the discretion of the Minister. Any decision is subject to judicial review.[4]

iii Scope

Healthcare

Under the Healthcare Market Regulation Act, the sole criterion in the jurisdictional test is that at least one healthcare provider, consisting of 50 or more employees providing healthcare directly or indirectly, is part of the concentration (target, acquirer or joint venture partner, including portfolio companies). 'Healthcare provider' is defined as an undertaking directly involved in the treatment of patients whose services are covered under the Healthcare Insurance Act or the Long-Term Care Act. The law does not specify that the target needs to be active in the Netherlands or be a healthcare provider. The relevant act refers to the Dutch Competition Act for the definition of 'control', which is substantively similar to the concept of control prescribed by the EU Merger Regulation.[5]

Electricity and LNG facilities

Under the Electricity Act, there must be a change in control of an electricity generation facility with a nominal electricity production capacity of 250 megawatts or an undertaking that manages such an installation. This threshold is expected to be lowered to 100 megawatts. According to public sources, there are at least 35 of these installations in the Netherlands.

Under the Gas Act, there must be a change in control of an LNG installation or an undertaking that manages such an installation.

Both acts refer to the Dutch Competition Act for the definition of 'control', which is substantively similar to the concept of control prescribed by the EU Merger Regulation.

Telecommunications

The Minister has jurisdiction if the acquirer is to acquire or hold 'predominant control' of a telecommunications party that results in a 'relevant influence in the telecommunications sector'.

Predominant control exists in any of the following six situations:

- the acquisition of at least 30 per cent of the voting rights (solely or jointly). Although there is no formal guidance, this arguably does not include contractual veto rights;
- the ability to appoint or dismiss at least half of the executive or non-executive board members, or both;
- the ability to exercise control as a result of special shares stipulated in the articles of association, notably priority shares;
- where the target has a branch (i.e., a non-Dutch registered legal entity with permanent presence in the Netherlands) that is a telecommunications party;
- if a partner becomes fully liable towards creditors for the debts of the company acting under its own name; and
- the acquiring or holding party owns sole proprietorship.

A telecommunications party with a 'relevant influence in the telecommunications sector' is defined as an undertaking holding predominant control of any of the following infrastructure or services:

- telephony or internet access services to more than:
  - 50,000 consumer subscribers (fixed only) in the Netherlands;
  - 12,500 business subscribers (fixed only) in the Netherlands; or
  - 100,000 subscribers (mobile internet access services only) in the Netherlands;
- electronic communications networks used for the provision of telephony or internet access services to more than 100,000 end users in the Netherlands;

- internet exchange point with more than 300 connected autonomous systems. This is a network facility that enables the interconnection of more than two independent autonomous systems, primarily for the purpose of facilitating the exchange of internet traffic;
- data centre services with a power capacity of more than 50 megawatts;
- hosting services to more than 400,000 '.nl' domains;
- qualified trust services; and
- electronic communications networks or services, data centre services or trust services to any of the following customers:
  - Netherlands General Intelligence and Security Service;
  - Netherlands Ministry of Defence;
  - Netherlands Military Intelligence and Security Service;
  - National Coordinator for Security and Counterterrorism; or
  - Netherlands National Police.

From our exchanges with the Investment Screening Office, we understand that its substantive review focuses on the identity, nationality and track record of the investors, including all shareholders that own at least 5 per cent of the shares in the acquirer(s). In cases of acquisitions by private equity funds, the Ministry has asked for information on all limited partners controlling at least 5 per cent in the committed capital in the acquiring funds. In addition, acquirers will be asked to specify which jurisdictions control at least 2.5 per cent of the total committed capital in the private equity fund. The Minister will also investigate the control and information rights of the limited partners and may request copies of limited partnership agreements.

Vifo Act

The Vifo Act introduced a mandatory notification requirement for acquisition activities in target undertakings that provide or operate vital processes, sensitive technology and managers of a corporate campus (see further below).

The target undertaking must be established in the Netherlands, meaning that either its policy is determined or its economic activities are carried out in the Netherlands. The scope of the Act arguably also captures acquisitions of foreign parent companies that can exercise control or, in the case of 'highly sensitive technology' only, exercise significant influence over such an undertaking established in the Netherlands. Legal form is irrelevant, as is where the registered office is located. Although there is no decisional practice yet, it is clear that the mere presence of turnover or assets, or both, in the Netherlands could be sufficient to trigger a notification. The same arguably applies to undertakings that are effectively managed from the Netherlands but that do not have local turnover or assets.

Vital processes

The regime covers changes in control (within the meaning of the EU Merger Regulation) of operators of vital processes or their essential assets that, if disrupted, affected or removed, would result in serious social disruption in the Netherlands. The regime applies to target undertakings engaged in any of the following activities:

- district heating: transport of district heating;
- nuclear energy: either or both the holder of an authorisation based on the Dutch Nuclear Energy Act or any other undertaking subject to confidentiality obligations under the Dutch Nuclear Energy Act Confidentiality Decree;
- Amsterdam airport: (1) Royal Schiphol Group NV (the airport owner and management company) or any of its group companies; (2) an air carrier holding one-third or more of available annual slots (currently KLM); and (3) fuel supply, storage and processing;
- Rotterdam seaport: Harbour Master's Division of the Port of Rotterdam Authority;
- credit institutions: banks with a corporate seat in the Netherlands that qualify as significant in accordance with Article 6(4) of Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank (ECB)

concerning policies relating to the prudential supervision of credit institutions – in other words, a bank that meets any of the following criteria: (1) the total value of its assets exceeds €30 billion; (2) the ratio of its total assets over the GDP of the Netherlands exceeds 20 per cent, unless the total value of its assets is below €5 billion; or (3) following a notification by its national competent authority that it considers such an institution of significant relevance with regard to the domestic economy, the ECB makes a decision confirming that significance following its own comprehensive assessment, including a balance sheet assessment, of that credit institution;
- trading facilities: operator of a trading facility in the Netherlands that accounts for 50 per cent or more of the nominal value of all securities traded in the Netherlands;
- financial market infrastructure: (1) central counterparties as defined in Article 2(1) of Directive 648/2012 Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on over-the-counter derivatives, central counterparties and trade repositories; (2) a clearing house or financial institution that processes more than one billion domestic and cross-border transactions per year; (3) a clearing and settlement institution; or (4) a central institute with a seat in the Netherlands;
- natural gas extraction: a holder of an authorisation of natural gas extraction at the Groningen gas field (currently NAM) or GasTerra; and
- natural gas storage: a holder of an authorisation for the storage of natural gas based on Article 9a of the Gas Act or storage of any substance (such as carbon dioxide) more than 100 metres below the surface.

Sensitive technology

Notifiable transactions involving providers of sensitive technology or their essential assets include a change of sole or joint control within the meaning of the EU Merger Regulation or significant influence (i.e., below the level of ‘control’). For ‘highly sensitive technology’, the Vifo Act applies different thresholds for the acquisition or increase of significant influence. These thresholds are 10 per cent, 20 per cent and 25 per cent of the votes in the shareholders’ meeting of the target undertaking. Furthermore, the following can be considered as a significant influence: (1) the contractual obligation of the target undertaking (e.g., as laid down in an investment agreement) to ensure or promote the appointment or dismissal of one or more directors nominated by the acquirer; or (2) the agreement between shareholders that a shareholder can exercise significant influence. ‘Highly sensitive technology’ concerns goods and technology that are essential to the functioning of the defence, police, intelligence and security services of the Netherlands, such as semiconductors.

‘Sensitive technologies’ are defined as follows:

- dual-use goods that are subject to export control under the EU Dual-Use Regulation 2021/821, namely goods that can be used for both civilian and military use;
- military goods: this refers to the Dutch implementing regulation of Council Common Position 2008/944/CFSP of 8 December 2008, which defines common rules governing the control of exports of military technology and equipment and also concerns military or dual-use goods, or both; and
- quantum technology, photonics, semiconductors and high assurance products.

Manager of a corporate campus

This regime covers changes in control (within the meaning of the EU Merger Control Regulation) of managers of ‘corporate campuses’, which are defined as undertakings ‘that manage an area in which a collection of companies is active and in which public-private cooperation takes place on technologies and applications that are of economic and strategic importance for the Netherlands’. According to the explanatory memorandum, this is supposed to capture managers of campuses such as the High Tech Campus Eindhoven, which is occupied by multiple companies that are active in the high-tech and life sciences industries.

In a letter dated 8 July 2022, the Minister identified a number of challenges regarding the practical application of the amendment:

> *in particular, as regards the conceptualization and delineation of the target undertakings and the scope of the amendment. In addition, it will be difficult for campus managers to determine whether they have a duty to report and are covered by the bill due to lack of understanding of the technology present among their tenants.*[6]

The Minister therefore commissioned an external expert study focusing on the practical implementation of the amendment. Guidelines intended for campus managers to determine for themselves whether they fall within the scope of the regime are expected later in 2023.

iv Voluntary screening

The aforementioned legislation prescribes mandatory notification obligations. If there is any doubt whether an investment constitutes a notifiable transaction, parties can choose to voluntarily consult the NZa or the Investment Screening Office.

v Procedures

Healthcare

The NZa review period is four weeks, subject to suspension if there are information requests. This period can be extended by six months in the event of an in-depth review and is subject to stop-the-clock provisions if there are information requests. Although there is no deadline for submitting a notification, the regime has a suspensory effect, meaning that the transaction cannot be implemented prior to approval from the NZa.

As part of the notification, the healthcare provider must, inter alia, provide information about the transaction structure, activities of the parties concerned, the manner in which stakeholders (notably employees, clients and patients) were consulted and involved in making the decision about the transaction, and the anticipated effects on the healthcare services. In the event that one of the parties is a provider of crucial care, such as ambulance services, the notification must be accompanied by an effects report. The test performed by the NZa is mostly procedural and examines whether stakeholders have been adequately consulted. Where crucial care is involved, the NZa will assess whether the concentration results in changes to the quality, accessibility and availability of healthcare services.

Energy

The notification must be made at least four months prior to the envisaged date of completion of the transaction. The notification does not have suspensory effect, meaning that the transaction can be implemented prior to the Minister's decision. The decision period is also four months. However, the transaction would have to be unwound or remedies implemented with retroactive effect if the Minister were to decide to block the transaction or impose conditions. The notification form should include information about the parties concerned, a description of the energy installations, the acquirer's existing activities in the electricity and LNG industries, the manner in which the acquirer intends to finance the acquisition, and the acquirer's business plan and strategy. The Minister will assess whether the transaction results in risks for national security or continuity or reliability of the energy supply.

Telecommunications

A notification under the telecommunications regime must be made at least eight weeks prior to the envisaged date of completion of the transaction or no later than the date of the launch of a public offer. The review period is eight weeks, subject to suspension if there are information requests. This decision period can be extended by six months in the event of an in-depth review and is subject to stop-the-clock provisions if there are information requests. Similar to the energy regime, the notification does not have suspensory effect.

The notification form includes information about the telecommunications activities of the parties, financial status, track record of the acquirer and business strategy. The Minister will assess whether the acquirer poses a risk to the continuity, reliability and confidentiality of the telecommunications party. The aim of the regime is primarily to protect key telecommunications infrastructure against foreign interference that could pose a risk to national security. The Minister must prove that there are concrete suspicions that the identified risk can actually materialise. The standard of proof appears to be relatively high.

National security regime

The review period will be eight weeks, which can be extended by six months in the event of an in-depth review. The review period can be suspended if there are information requests. Although there is no deadline for making a notification, the regime has suspensory effect, and standstill obligations apply until the Minister has (conditionally) cleared the transaction.

The information required in the notification form is similar to that under the telecommunications regime. The focal point of the Minister's appraisal is national security, which pertains to the following:

- the continuity of the critical processes;
- the integrity and exclusivity of knowledge and information associated with vital processes and sensitive technology; or
- the creation of strategic dependencies.

The Vifo Act states various elements that the Minister may take into consideration in the appraisal, including factors that relate to the investor itself (e.g., track record, financial stability, transparent ownership structures and motives) and its home state (e.g., sanctions adopted against the state, stability of the state or region, geopolitical programmes and separation between civil and military research and development programmes).

vi Prohibition and mitigation

In its 2022 annual report, the NZa noted an increasing involvement of foreign investors and private equity parties, with (apparent) particular focus on providers of dental care.[7] As indicated, we are not aware of any cases that the NZa prohibited or on which it imposed remedies when clearing concentrations during the past year. The only case in which the NZa has imposed remedies was in April 2019, when the authority imposed reporting obligations in respect of the cooperation between two merged hospitals in the Rotterdam area.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

The Electricity Act and the Gas Act prescribe prohibitions on the privatisation of electricity and gas transmission system operators and distribution system operators. Private investors (both domestic and foreign) cannot acquire such companies.

ii Restricted sectors

As outlined above, sector-specific screening legislation applies to various sectors: healthcare, telecommunications, electricity and LNG. Details of this legislation and the competent authorities are described above. The government is in the process of preparing a legislative proposal that will apply to the defence industry. There are no sectors in which foreign investment is subject to caps or other requirements, such as an obligation to team up with a local partner. For completeness, we note that the Mining Act provides that the Dutch state will be entitled to 40 per cent of the proceeds of any mining concession, potentially through a 40 per cent stake in the relevant entity.

V TYPICAL TRANSACTIONAL STRUCTURES

As outlined above, notification obligations apply irrespective of the nationality of the acquirer(s) and there are no corporate law residency requirements. The way in which a transaction is structured (e.g., asset or share deal) typically does not affect the analysis, provided that (depending on the regime) control, significant influence or specified percentages of voting shares are acquired. The Minister will look through the corporate chain up to the ultimate entity or person. Investors based in sensitive jurisdictions can expect closer scrutiny from the Minister as part of the appraisal, potentially resulting in longer review periods and a higher likelihood of commitments to remedy any national security concerns.

VI OTHER STRATEGIC CONSIDERATIONS

As described above, the national security regime will apply with retroactive effect. Although expected to be used rarely, the Minister will be able to retrospectively call in transactions that:

- close after 8 September 2020 and before the date the national security regime entered into force (1 June 2023);
- give rise to national security concerns; and
- have not been subject to a public interest intervention under the current sector-specific regimes.

If called in, transactions will have to be notified and will be subject to substantive review. Transactions that have not been completed by the time the new regime comes into force and that satisfy the mandatory notification requirements will need to be notified and cleared before closing. If a deal subject to the mandatory regime has not closed before the regime has entered into effect, closing will not be permitted until clearance is received. Without clearance, the deal will be legally void and subject to financial penalties. Investors must therefore self-assess whether deals may fall under the mandatory regime and build this process into any deal timetable. Investors currently negotiating deals that may not complete prior to the new regime coming into force should ensure that they include appropriate conditionality, risk allocation measures and long-stop dates for a potential notification and review period.

VII OUTLOOK

It is expected that new legislation will enter into effect under which the ACM will take over the test currently performed by the NZa in relation to concentrations involving healthcare providers. The legislative proposal was amended at the beginning of 2020, following input from the NZa and the ACM. It is uncertain when this legislative proposal will be introduced. As outlined above, the Dutch government is in the process of preparing a legislative proposal that will apply to the defence industry. This proposal is expected in late 2023.

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Endnotes

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2 Government coalition agreement 2017–2021, p. 34. Available at: https://www.rijksoverheid.nl/documenten/publicaties/2017/10/10/regeerakkoord-2017-vertrouwen-in-de-toekomst.
3 Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union.
4 Under the Financial Supervisory Act, the acquisition of a qualifying holding in a bank or insurance company may be subject to a declaration of no objection notification to the Dutch Central Bank. This will not be discussed further in this chapter.
5 Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EU Merger Regulation).
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Chapter 17

Norway

Simen Klevstrand and Karoline Narvestad Maurtvedt[1]

Summary

I OVERVIEW

Unlike an increasing number of jurisdictions across the world, Norway does not have a general foreign direct investment (FDI) screening regime in place. Instead, Norwegian national security interests are protected under Section 2-5 and Chapter 10 of the Security Act.[2]

Chapter 10 of the Security Act creates a limited mandatory filing regime for investments in companies that have been brought within the scope of the Act by way of an individual decision issued by the relevant government ministry under Section 1-3. In practice, this means that the filing obligation currently covers investments in a limited number of companies.

Under new legislation not yet in force, the filing obligation will be expanded to include investments in companies that have received a security clearance under Section 9-3 of the Act. As at July 2023, no date of entry into force has been set. See further descriptions of the amendments in Section II.ii, below.

While the mandatory filing rules have a limited scope, the Norwegian government has virtually unrestricted powers to review non-notifiable transactions on the grounds of national security. This is a result of Section 2-5 of the Act, which has been used to block one transaction since the entry into force of the Act in 2019. As a result, parties involved in transactions that could give rise to potential national security concerns may consider approaching the authorities on an informal basis.

In October 2022, the Norwegian government appointed a committee to assess the need for a general FDI regime in Norway. The committee will deliver a report by 1 December 2023 detailing whether additional protection of national security interests is needed and, if so, proposing adequate measures to this effect.[3]

As a result, it is possible that Norway will see significant legislative changes with respect to FDI screening in the coming years.

II YEAR IN REVIEW

i Review of transactions

In March 2023, for the first time, the Norwegian government imposed conditions on a transaction under Chapter 10 of the Security Act. The Abu Dhabi-based fund Mubadala acquired a minority stake in the Swedish parent of GlobalConnect AS, a company providing electronic communications services in Norway.

The conditions imposed pertained to non-disclosure of sensitive information from the target company and ensuring prior control over future transactions, as well as imposing certain restrictions on resales of shares in the target.[4]

No transactions covered by Norway's narrow mandatory filing regime under Chapter 10 of the Security Act have been prohibited outright, but, in 2021, the government blocked the non-notifiable acquisition of Bergen Engines (as further described in Section III.Vi, below).

According to the Norwegian National Security Authority, close to 50 acquisitions were reviewed on national security grounds in Norway in 2022.[5] The nature and details of these acquisitions, however, were not revealed. Although none resulted in blocking orders under the Security Act, it cannot be excluded that some transactions were abandoned as a result of informal contact with the relevant Norwegian authorities. The Norwegian National Security Authority further stated that about two-thirds of the transactions had connections to Russia or China.

ii Developments in legislation

There is currently an ongoing legislative process in Norway for the amendment of the mandatory filing regime under Chapter 10 of the Security Act. On 20 June 2023, the Norwegian Parliament passed a law amending the Act.[6]

Certain amendments entered into force on 1 July 2023, including, inter alia, an expansion of the Norwegian government ministries' powers to bring companies within the scope of the Security Act by way of an individual decision under Section 1-3. In addition to companies that are of essential importance to fundamental national functions, with respect to which the ministries shall issue decisions, the amended legislation opens for decisions being issued also to bring companies that are of significant importance to fundamental national functions within the scope of Chapter 10 (estimated to concern approximately 250 to 300 companies). See further description of the distinction between essential and significant in Section III.iii, below.

The amendments that affect the wording of Chapter 10 itself, however, are still pending, and the date of entry into force has not been set. The amendments may be summarised as follows:

- companies that have been granted security clearance under Section 9-3 in relation to the rules on classified procurements are automatically made subject to the filing obligation in Chapter 10;
- the buyer, seller and target company will all be responsible for filing a notifiable transaction (and not only the buyer alone as under the currently application legislation);
- the threshold for triggering a filing is lowered from one-third to 10 per cent of the share capital, shares or voting rights, and additional thresholds are added so that filings will also be triggered when further thresholds are exceeded (20 per cent, one-third, 50 per cent, two-thirds and 90 per cent of the share capital, shares or voting rights);
- a standstill obligation is introduced and will apply to all transactions subject to the mandatory filing obligation;
- a new Section 10-4 introduces a pre-clearance prohibition against the exchange of information that may be used for the purposes of security-threatening activities; and
- the introduction of new sanctions, including fines for failure to file before the closing of a transaction and criminal sanctions for failure to comply with a decision made under Section 2-5 or Chapter 10 (Section 10-3).

III FOREIGN INVESTMENT REGIME

i Policy

The main policy objective of the Security Act is to protect Norwegian national security interests. As stated in Section 1-1 of the Act, the purpose of the legislation is to:

- safeguard Norway's sovereignty, territorial integrity, democratic governance and other national security interests;
- prevent, detect and counter security-threatening activities; and
- ensure that security measures are implemented in accordance with fundamental legal principles and values in a democratic society.

'Other national security interests' within the meaning of the above-mentioned provision refers to Norway's sovereignty, territorial integrity, democratic governance and overarching security policy interests in relation to:

- the activities, security and freedom of action of the highest state organs;
- defence, security and emergency preparedness;
- relations with other states and international organisations;
- economic stability and freedom of action; and
- the fundamental functionality of society and the basic security of the population.[7]

Against this backdrop, the Norwegian authorities have two main types of review powers that are relevant in an FDI context. These are further described in Section III.iii, below, but, in short, consist of the following:

- the power to review and block notifiable transactions under Chapter 10 where companies have been made subject to the Security Act by way of individual decisions issued under Section 1-3 for being of 'essential' or 'significant' importance to national security interests; and

- a general power to call in, review and block transactions under Section 2-5 in order to prevent security-threatening activities or other planned or ongoing activities that may entail a not insignificant risk to national security interests.

ii Laws and regulations

As mentioned above, Norway does not currently have a general FDI regime in place. Instead, foreign investments are governed by the Security Act, which entered into force on 1 January 2019. The Norwegian reference to the Act is LOV-2018-06-01-24 *Lov om nasjonal sikkerhet*.

Sections 1-3 and 2-5 and Chapter 10 of the Security Act are most relevant for the purposes of FDI screening.

The government bodies responsible for administering the reviews vary depending on the sector or field in which the relevant target company is active. If a transaction is subject to the mandatory filing obligation under Chapter 10, the filing shall be submitted to the ministry responsible for the sector or field in which the target is active. As an example, the Ministry of Defence would be responsible for reviewing transactions involving targets within the military industry, such as manufacturers or suppliers of military equipment.

If no ministry is responsible for the relevant sector or field, it is the Norwegian National Security Authority that will conduct the review.

iii Scope

With respect to the scope of the Security Act, a distinction must be made between the Norwegian authorities' powers to review notifiable transactions under Chapter 10 and the general review powers under Section 2-5.

Mandatory filing obligations under Chapter 10

As a starting point, it should be noted that the scope of Chapter 10 is very limited in comparison with the typical sector- or industry-based FDI screening regimes in other jurisdictions. This is because Chapter 10 is applicable only to companies having been made subject to the Security Act by way of an individual decision from the relevant ministry. The decisions are confidential, and the list of companies concerned is not publicly available.

It follows that in order to determine whether a transaction may be subject to a mandatory notification obligation in Norway, an investor should request confirmation from the target as to whether it has received such an individual decision.

Chapter 10 applies to all companies having received an individual decision under Section 1-3 of the Security Act. Under this provision, the relevant ministry shall, within its area of responsibility, make decisions regarding the full or partial applicability of the Act to all entities that:

- handle classified information;
- control information, information systems, objects or infrastructure of essential importance to fundamental national functions, or of essential importance to national security interests without being directly linked to fundamental national functions; and
- engage in activities that are of essential importance to fundamental national functions, or of essential importance to national security interests without being directly linked to fundamental national functions.

From 1 July 2023, an amendment to Section 1-3 provides that the relevant ministry may also make decisions to bring companies within the scope of Chapter 10 when they are of significant importance to fundamental national functions, or of significant importance to national security interests without being directly linked to fundamental national functions.

The difference between essential and significant importance in this respect relates to the ability to continue operations of fundamental national functions without the company in question. A company may be of essential importance if, inter alia, fundamental national functions cannot be operated without it or if it is the sole supplier of its kind. On the other hand, a company may be of significant importance if it is a supplier of an essential company or it is active in a relevant market with few players.

The meaning of 'fundamental national functions' is set out in Section 1-5 of the Security Act and includes services, production and other forms of activities that are of such significance that a complete or partial failure of these functions would have consequences for the state's ability to safeguard national security interests.

Once a company has been made subject to Chapter 10, a mandatory notification obligation arises upon the acquisition by an investor of a qualified ownership interest in the relevant company. The meaning of 'qualified ownership interest' is set out in Section 10-1. Amendments lowering the ownership threshold have been passed but have not entered into force as at July 2023. As at July 2023, the threshold for qualified ownership is triggered by the direct or indirect acquisition of the following interests:

- at least one-third of the company's share capital, shares or votes;
- the right to become the owner of at least one-third of the share capital or shares; or
- significant influence over the management of the company in another manner.

As a result, both minority acquisitions and indirect acquisitions of local subsidiaries may trigger a mandatory filing obligation. In addition, any share capital or shares held or acquired by a 'connected person' shall be taken into account for the purposes of determining the qualified ownership interest held by the investor. Connected persons include, inter alia, spouses, children and other companies within the same group as the investor.[8]

There are no exemptions to the filing obligation once a company is brought within the scope of Chapter 10 and a qualifying ownership interest is acquired. No additional monetary thresholds apply, and no exemptions apply for Norwegian, EEA or EU investors. The Act simply refers to the 'acquirer' and does not distinguish between domestic or foreign investors.

Finally, and although Chapter 10 has been in force since 2019, no transactions have been blocked under this regime, but, as mentioned above, the government imposed conditions in March 2023 on the indirect investment in GlobalConnect.

General review powers under Section 2-5

Under Section 2-5 of the Security Act, the King in Council (the government) has a nearly unlimited power to intervene in any transaction on the grounds of national security interests. The provision empowers the government to make decisions necessary to prevent security-threatening activities or any other planned or ongoing activity that may entail a not insignificant risk to national security interests. There is no statutory limitation period on the government's powers in this respect.

Section 2-5 has so far been used to block one transaction: the sale of Rolls-Royce's Norwegian subsidiary Bergen Engines to a Russian-controlled buyer. The case is further described in Section III.vi, below.

iv Voluntary screening

The Norwegian Security Act does not provide for a formal voluntary filing procedure. As a result of the government's far-reaching powers under Section 2-5, however, parties to transactions that could potentially give rise to national security concerns may choose to approach the government for informal discussions. No binding clearance decisions are issued in such informal contact due to the lack of a formal voluntary filing regime.

It is worth noting that in the consultation paper published by the Ministry of Justice and the Ministry of Defence in 2021, which set out the initially proposed amendments to the Security Act, input on whether to introduce a voluntary filing regime was requested. The government, however, ultimately decided against introducing a voluntary filing regime at this point in time.

v Procedures

As further described above, a filing is mandatory if a qualified ownership interest is acquired in a company that has been made subject to Chapter 10 by way of an individual decision.

The filing must be submitted to the relevant ministry or the Norwegian National Security authority as applicable and there are no filing fees. With respect to the format of the filing, no specific filing forms, either normal or 'short form', exist. However, the acquirer must, in general, provide information regarding personal or company details, ownership and management if relevant, relationships with or ownership of other companies within the target's sector or other companies subject to the Security Act, and any other information that may assist the authorities in carrying out the review.

The Security Act or other related guidelines do not provide any guidance on or create a system for pre-notification procedures. Although investors may informally contact the relevant ministry or the Norwegian National Security Authority for general guidance, they will not be able to obtain any pre-approval decisions prior to the actual filing.

No standstill obligation applies under the currently applicable legislation, but this will change once the 2023 amendments enter into force.

The timeline for the review of Chapter 10 filings is set out in Section 10-2. The relevant ministry or the Norwegian National Security Authority must inform the acquirer within 60 working days whether the transaction is cleared or whether it will be referred to the King in Council (the government) for further review. The subsequent period of review by the government is not regulated by statute. If the ministry or the Security Authority issues requests for information to the acquirer within the first 50 working days following receipt of the filing, the clock on the 60-working-day review period stops running until the requested information has been provided. There are no other review procedures or fast-track options provided for in the Security Act.

While filings will be reviewed and may be cleared by ministries or the Norwegian National Security Authority, it is only the King in Council (the government) who has powers to block transactions. Under Section 10-3 of the Security Act, the government may block or impose conditions on acquisitions that may entail a not insignificant risk of threat to national security interests. This includes the power to reverse any transactions that have already been closed or implemented.

Failure to notify under the currently applicable legislation does not lead to fines or criminal liability, as there is no obligation in the legislation to file prior to closing or implementation of the transaction (i.e., no offence of gun-jumping currently exists). This will, however, change once the 2023 amendments enter into force. See further descriptions of the amendments in Section II.ii, above.

vi Prohibition and mitigation

No public statistics exist with respect to the number of transactions subject to review, prohibition or mitigation on an annual basis. However, due to the very limited scope of the mandatory filing regime, the number of transactions reviewed yearly is believed to be small. No decisions have been blocked under the Chapter 10 regime since the entry into force of the Act in 2019, but, as mentioned above, the government imposed conditions in March 2023 on the indirect investment in GlobalConnect.

The general review powers of the government under Section 2-5 have been used to block a transaction on one occasion, in the *Bergen Engines* case in 2021. The transaction was not subject to the mandatory filing obligation under Chapter 10 but was called in for review when the Norwegian government became aware of its existence.

The transaction concerned the sale of Rolls-Royce's Norwegian subsidiary Bergen Engines to the Russian-controlled buyer TMH International. Bergen Engines is a supplier of marine diesel engines to both civil and military customers. The transaction was blocked on the basis of concerns that TMH International would gain access to and use goods, information and technology held by Bergen Engines in a way that could threaten Norwegian national security interests. In its decision, the government highlighted, inter alia, the fact that the technology could potentially enhance Russia's military capabilities, TMH International's close affiliation with the Russian government, the possibility of circumventing export control rules with respect to technology Russia had struggled to gain access to since 2014 and the strategic nature of the location of Bergen Engines' property being in the vicinity of an important Norwegian port.

IV SECTOR-SPECIFIC REQUIREMENTS

Both the review powers under Chapter 10 and Section 2-5 of the Security Act are of general application (i.e., transactions within all sectors and industries will be reviewed under these provisions). No separate sector-specific review mechanisms are currently in place, but there are ownership restrictions in certain industries, such as for ownership in hydropower production as well as fisheries and the agricultural sector. As further described in Section VII, below, a new general FDI regime may be introduced during the coming years.

V TYPICAL TRANSACTIONAL STRUCTURES

Investment in Norway is often made through a Norwegian limited liability company (AS), but it is entirely possible for a foreign entity to acquire the shares in a Norwegian business directly. The choice between a share purchase and an asset purchase may often be affected by tax considerations. Norwegian rules generally do not put foreign owners at a disadvantage compared with Norwegian owners, and there is no requirement or general advice to partner with domestic players for investments.

VI OTHER STRATEGIC CONSIDERATIONS

Compared with FDI regimes in many other jurisdictions, it is a relatively straightforward process to determine whether a mandatory filing obligation arises in Norway. For an investor seeking to enter into a transaction with a Norwegian company, or a foreign company with a Norwegian subsidiary, it will be sufficient to request information as to whether the company has been made subject to Chapter 10 of the Security Act by way of an individual decision from the relevant government ministry.

If no such decision has been received, the transaction in question will not trigger a mandatory filing obligation. If a decision has been received, it must be considered whether the contemplated transaction structure falls within the scope of the decision.

Under the 2023 amendments, the filing obligation will be expanded to include investments in companies that have received a security clearance under Section 9-3 of the Act. As at July 2023, no date of entry into force has been set.

Note that the transaction in any case remains subject to the general review powers of the government under Section 2-5 of the Security Act. As a result, parties involved in transactions that could give rise to potential national security concerns may consider approaching the authorities on an informal basis.

Due to the narrow scope of the currently applicable mandatory filing regime, the number of formal filings submitted, although confidential, is believed to be small. It follows that the interface between merger control and FDI in Norway, including the number of transactions subject to parallel merger control and FDI review procedures, is currently very limited. It remains to be seen, however, how this may change if a general FDI regime is introduced, both with respect to formalities such as aligning the statutory limitations on review periods and with respect to the interplay between the regimes in cases where the protection of national security interests may be seen as restrictive of competition.

VII OUTLOOK

Norway is following the global trend and taking steps to expand the scope of its mandatory filing regime. As further described in Section II.ii, above, amendments to the Security Act expanding the scope of companies that may be made subject to the Chapter 10 filing obligation entered into force on 1 July 2023. In addition, the Norwegian Parliament has adopted several other amendments, including a new filing obligation for acquisitions of companies with a Section 9-3 security clearance; lowering and adding multiple thresholds capable of triggering filings; making the buyer, seller and target responsible for filing; introducing a standstill obligation; and introducing a separate provision on information exchange prior to clearance. The date of entry into force of these amendments has not been set.

In addition to the above-mentioned changes to the existing legislation, the government has appointed a committee to review and assess the need for a separate FDI regime. The committee will deliver a report to the government within 1 December 2023 setting out their views on the need for increased control and screening of companies that are not currently subject to the Security Act, including whether there are values, technologies or knowledge that are not adequately safeguarded under the current regime.

According to the committee's mandate, the elements that must be assessed include, inter alia, whether the current regime sufficiently safeguards Norwegian business and trade policy interests, as well as the need for predictability, knowledge and transparency with respect to filing obligations in the business sector; whether the regime aligns with the requirements of the EU Screening Regulation, the Organisation for Economic Co-operation and Development's guidelines on the drafting of screening frameworks and other relevant international standards; and how to best balance the need for adequate control over security-threatening activities with business and foreign policy considerations.

As the committee's report is due towards the end of 2023, any new legislation resulting from the committee's work is not likely to enter into force until late 2024 or, more likely, in 2025.

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Endnotes

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2 Date of entry into force: 1 January 2019. Norwegian reference: LOV-2018-06-01-24 *Lov om nasjonal sikkerhet*.

3 The Norwegian government's press release and the committee mandate are available on the government's website (in Norwegian only): https://www.regjeringen.no/no/aktuelt/regjeringen-vil-utredebehovet-for-narmere-sikkerhetsvurderinger-av-utenlandske-investeringer/id2942007/.

4 The government's press release is available in Norwegian at https://www.regjeringen.no/no/aktuelt/regjeringen-setter-vilkar-knyttet-til-kjop-av-eierandel-i-globalconnect/id2970605/.

5 Press release from the Norwegian National Security Authority on 22 March 2023. Available in Norwegian at https://nsm.no/aktuelt/sikkerhetskonferansen-2023-krisen-kan-ramme-i-morgen.

6 The draft proposal is available in Norwegian only. Norwegian reference: Prop. 95 L (2022-2023) *Proposisjon til Stortinget (forslag til lovvedtak) Endringer i sikkerhetsloven (eierskapskontroll og lovens virkeområde)*.

7 Security Act, Section 1-5.

8 Securities Trading Act (2007), Section 2-5. Norwegian reference: LOV-2007-06-29-75 *Lov om verdipapirhandel (verdipapirhandelloven)*.

Chapter 18

Portugal

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Summary

I OVERVIEW

Foreign investment has been one of the most prominent cornerstones in Portuguese policymaking for more than a decade. Multiple legislative and political initiatives have been promoted to enhance the country's global competitiveness. According to data compiled by the World Bank, Portugal is the 39th easiest country in the world in which to do business, and the 12th of countries within the European Union (outranking the Netherlands, Belgium and Italy).

Despite having endured two back-to-back economic crises – the sub-prime crisis (2012) and the covid-19 recession – the Portuguese economy has been steadily growing thanks to economic recovery and pro-business policies.

II YEAR IN REVIEW

The year 2023 has been one of legal and regulatory reform. In particular, asset management law has been restructured to create a more harmonised, coherent and uniform regulatory policy approach to promote supervisory effectiveness and competitiveness within the sector, including the adoption of solutions that are more in line with EU law.

Also, in 2022, the Portuguese Competition Authority (AdC) took the opportunity of the transposition of the ECN+ Directive[2] to propose some adjustments to the existing Portuguese competition law framework. Most of these adjustments have been implemented through the adoption of Law No. 17/2022 of 17 August amending the Portuguese Competition Act,[3] and have incremented the AdC's powers to investigate anticompetitive practices.

Notwithstanding the economic effects of the covid-19 pandemic, the war in Ukraine and associated economic sanctions on the Russian Federation, the Belarus government, and Russian and Belarus economic players have sent the world into a cycle of economic retraction. The consequences of sanctions, despite being severe, have had little effect in Portugal, owing to the country's growing commitment to transitioning to a low-carbon economy.

III FOREIGN INVESTMENT REGIME

i Policy

One of the current ideas for ways to attract foreign investment is to transform Portugal into a sandbox for technological solutions of issues arising in relation to cities, networks, energy, resource management, mobility and waste management and treatment, undertaken in liaison with Portuguese companies.

Another way of attracting foreign investment is through the external promotion of some of Portugal's key assets, alongside the creation of international consortiums to develop these resources:

- mineral resources, such as lithium, cobalt, nickel, niobium, tantalum and rare earths;
- the sea and, in particular, the Portuguese exclusive economic zone, which extends to the outer limit of the continental shelf; and
- hydrothermal fields.

Moreover, in line with the EU's European Green Deal goals, another key national strategy for obtaining foreign investment has been a focus on the renewable energy industry sector, where Portugal has shown itself to be one of the best countries in which to invest.

ii Laws and regulations

Portugal's legal environment encourages foreign investment. The country has no foreign capital entry restrictions and Portuguese law prohibits any discrimination between investments based on nationality.

With regard to foreign direct investment (FDI) measures, no changes to the Portuguese FDI legal framework[4] (which has been in force since 2014) have been made during the past year.

iii Scope

Most foreign investment in Portugal continues to be unregulated. As a general rule, Portuguese law does not impose any specific restrictions on foreigners or foreign investment in corporate matters, as regulations on the incorporation of companies, mergers and acquisitions, day-to-day business activities, duties and liabilities of shareholders and directors, merger control and antitrust all apply irrespective of nationality. The Portuguese framework on corporate groups is based on the central concept of an affiliated company, deemed to exist upon the occurrence of legally defined types of relationships between companies. Holding companies are legally authorised to direct the management of their subsidiaries if a company is wholly controlled by another company or a company agrees to subject its management to the direction of another company (which may or may not be its parent company). One should take into consideration that some of the aspects of the legal framework on groups and, in particular, the possibility of issuing binding orders and the liability of the holding company are applicable only if the registered offices of both companies are located in Portugal.[5]

Authorisation is required only when investing in sensitive areas, in particular defence and other regulated areas (e.g., banking, media and financial services). Foreign investors in Portugal must also take into consideration EU and national competition rules and other EU policies.

iv Procedures

Banking and other financial institutions

Summary of supervisory system

The provision of banking services is a regulated activity that must be carried out professionally by authorised credit institutions or financial companies, and is subject to the supervisory powers of the regulatory authority of the Member State of origin.

Supervision of the Portuguese banking system is governed by the Portuguese Credit Institutions and Financial Companies Legal Framework, approved by Decree-Law 298/92 of 31 December, as amended, and the notices, instructions and circulars issued by the Bank of Portugal. The supervision of credit institutions and, in particular, their prudent supervision, including monitoring activities carried out abroad, is entrusted to the Bank of Portugal under its basic law enacted by Law 5/98 of 31 January, as amended, and Decree-Law 298/92.

With the introduction of the General Framework for Investment Companies, approved by Decree-Law 109-H/2021 of 10 December, a new type of financial institution has emerged – the investment firm – having as its sole supervisor the Portuguese Securities Market Commission (CMVM). With a simpler incorporation procedure, these entities may provide investment services (and related ancillary services) in Portugal, but do not have the necessary authorisation to grant credit and perform similar financial operations.

Insurance

Summary of supervisory system

The provision of insurance services is a regulated activity and must be carried out professionally by authorised insurance companies, and is subject to the supervisory powers of the regulatory authority of the Member State of origin.

Supervision of the Portuguese insurance system is governed by (1) Law 147/2015 of 9 September, as amended, which establishes the legal framework and requirements for taking up and pursuing insurance and reinsurance activities; (2) Law 7/2019 of 16 January, which establishes the legal framework for the distribution of insurances and reinsurances; and (3) the regulations and circulars issued by the Portuguese Insurance and Pension Funds Supervisory Authority.

Energy

Summary of the supervisory system

The supervision of energy production, transport, distribution and trade is regulated by Decree-Law 97/2002 of 12 April, as amended. Article 1 thereof establishes the Energy Services Regulatory Authority as the domestic regulatory authority for the gas and electricity sectors.

Production, transport, distribution and trading of electricity

The legal framework for the production, transport, distribution and trading of electricity is regulated under Decree-Law 15/2022 of 15 January, which establishes the general grounds for the organisation and functioning of the national electricity system and regulates the production, transport, distribution and trading of electricity in Portugal.

Production

Decree-Law 15/2022 of 15 January establishes that energy production activities under the ordinary regime are free, subject to the granting of a production licence following a request by the licensing entity.

Transportation and distribution

Both the transportation and distribution of electricity must be carried out under a public service concession agreement awarded through a public tender, unless the concession is granted directly to a state-controlled entity. The concession is performed under a public service framework based on its classification as a public utility.

Trading

Decree-Law 15/2022 of 15 January states that trading in electricity is free, subject to a licence granted by the licensing entity. The licence must be requested by a company that is registered in an EU Member State.

Telecommunications

The legal framework governing the telecommunications sector is regulated under Law 5/2004 of 10 February, as amended (the Electronic Communications Law).

Pursuant to the Electronic Communications Law, the provision of electronic communications networks or services requires a general authorisation. Companies that intend to offer electronic communications networks and services must submit a short description to the regulator, ANACOM, of the network or service they wish to initiate, and give notice of the date on which the activity is expected to commence, submitting any further details necessary for their full identification under terms to be defined by ANACOM. Once that notification is made, undertakings may immediately commence the activity, subject to the limitations resulting from the allocation of rights to use frequencies and numbers.

Television broadcasting

The legal framework for television broadcasting is based on the Television Act,[6] which governs access to and the exercise of television activity. The main regulatory authority for this activity is the Portuguese Regulatory Authority for the Media.

The Television Act establishes that channel licences are granted through a public tender, and lays down restrictions regarding minimum capital requirements and the ownership of capital (in particular regarding political associations and trade unions, among other things).

Air transport

Portuguese law does not impose any specific restrictions on foreigners or foreign investments in air transport matters. Most mandatory requirements and procedures are established in Regulation (EC) No. 1008/2008 of the European Parliament and of the Council of 28 September 2008, as amended, on common rules for the operation of air services in the Community. For an undertaking to be granted an operating licence by the competent licensing authority (in Portugal, the ANAC, pursuant to Decree-Law 40/2015 of 16 March), EU Member States or nationals of EU Member States must own more than 50 per cent of the undertaking and effectively control it, directly or indirectly, through one or more intermediate undertakings, except as otherwise established in an agreement with a third country to which the European Union is a party.

IV SECTOR-SPECIFIC REQUIREMENTS

Restricted sectors

In general, foreign and domestic companies are free to invest in any industry. However, there may be specific requirements when performing activities for the public administration sector, such as winning a bid for a concession contract.

Therefore, private firms, except when licensed by a public entity through an administrative contract, are prohibited from directly carrying out the following economic activities:

- the collection, treatment and distribution of drinking water and disposal of urban wastewater, both through fixed networks, and solid waste collection and treatment in the case of municipal and multi-municipal systems;
- rail transportation operated for public services;
- the operation of seaports; and
- the exploitation of natural resources of the subsoil or that may be considered part of the public domain.

Similarly, foreign investment projects must be compatible with specific legal requirements if they could in any way potentially affect public policy or safety or health matters.

Projects of this nature require an assessment of compliance with statutory requirements and preconditions established under Portuguese law.

Included in this category are activities concerning the production of weapons, munitions and war materials, or those that involve the exercise of public authority. These activities must comply with legally mandatory conditions and requirements, and thus require specific licences. Access conditions and the pursuit of commerce and industry involving goods and military technology are regulated by Law 49/2009 of 5 August, namely the conditions of access to trading activities (in addition to the purchase, sale and lease activities of any of its contractual forms, import, export, re-export activities or flows of military goods and technologies, as well as broker-related business) and industry (research, planning, testing, manufacturing, assembly, repair, modification, maintenance and demilitarisation of military goods or technology) of military goods and technologies, as well as military activities themselves, either by enterprises and individuals based in Portugal or by qualified entities in other EU Member States.

Non-European investment in national strategic assets – those in connection with the main infrastructures and assets relating to defence and national security, or to the basic energy, transportation and communication services – may have to comply with the Strategic Assets Special Framework.[7] This Framework sets out some restrictions that specifically apply to entities from outside the European Union and the European Economic Area (foreign investors) that intend to acquire direct or indirect control (control) over assets in specific sectors of the economy: main infrastructures and assets relating to defence, national security, energy, transportation and communication services (strategic assets).

According to the framework set out in the Strategic Assets Special Framework, the Portuguese Council of Ministers, following a proposal by the minister overseeing the sector to which the relevant strategic asset pertains (the sector minister), may oppose the conclusion of a transaction in relation to a strategic asset in the event that it results in the direct or indirect acquisition of control of that strategic asset by a foreign investor, and that circumstance poses a real and severe threat to national security or the provision of basic services considered fundamental to the country. The procedure *ex officio* for clearing the acquisition of control by a foreign investor over a strategic asset is outlined below.

Within 30 calendar days of the execution date of the relevant agreement (or other legal instrument, as applicable) pursuant to which the foreign investor will directly or indirectly acquire control over a strategic asset, or of the date the transaction became public knowledge, if later, the sector minister may initiate an assessment procedure to determine the risk that the acquisition may pose to national security or the provision of basic services considered fundamental to the country.

When the procedure referred to in point (a) is opened, the foreign investor is legally obliged to provide all information and documentation requested by the sector minister. The minister in charge of foreign affairs and the minister in charge of national and homeland security are immediately notified of the opening of the procedure.

Within 60 calendar days of delivery by the foreign investor of the information or documentation requested by the sector minister, the Council of Ministers may oppose completion of the transaction envisaged by the foreign investor.

If the Council of Ministers opposes completion of the transaction envisaged by the foreign investor, the legal instruments underlying the transaction, and any subsequent acts relating thereto, including transfer of ownership of the strategic asset, are null and void.

The decision by the Council of Ministers to oppose completion of the transaction is subject to appeal by the foreign investor.

In addition to the procedure *ex officio* described above, which is triggered by the sector minister, the foreign investor may, on its own initiative, request confirmation from the sector minister that the envisaged transaction will not be opposed by the Council of Ministers. If the request for confirmation is not answered within 30 days, the Strategic Assets Special Framework sets out that tacit confirmation is given. The request for confirmation must be accompanied by a description, provided by the foreign investor, of the terms and conditions of the intended transaction involving the acquisition of control over the strategic asset.

The real and severe threat to national security or the provision of basic services considered fundamental to the country is asserted exclusively by the following criteria:

- the physical security and the integrity of the relevant strategic asset;
- the permanent availability and operability of the relevant strategic asset, as well as its ability to fully comply with its obligations, in particular the functions of public service that are the responsibility of the entities that control them, in the terms prescribed by law;
- the continuity, regularity and quality of the services of public interest to be provided by the person or company who controls the relevant strategic asset; and
- conservation of the confidentiality, imposed by law or public contract, of the data obtained during the course of activity by those who control the relevant strategic asset and of the technological resources required for management of the relevant strategic asset.

Moreover, the acquisition by a foreign investor of control of a strategic asset is considered to be potentially capable of representing a threat to national and homeland security or to the provision of basic services considered to be fundamental for the country whenever:

- there is serious evidence, based on objective factors, of the existence of a connection between the purchaser and third countries that:
  - does not observe the principles of the rule of law;
  - represents a risk to the international community as a result of the nature of its alliances;

    - maintains relations with criminal or terrorist organisations or with persons associated with such organisations, taking into account the official positions of the European Union in these matters, if any;
    - where the purchaser has used, in the past, a controlling shareholding held over other assets with the purpose of creating serious difficulties in the regular provision of essential public services in the country where it was located or in neighbouring countries; or
    - does not ensure either the allocation of the assets to its main function or their reversion at termination of the corresponding concession agreements, if applicable, in particular considering the absence of appropriate contractual provisions for said purpose; or
- the relevant transaction alters the function of the relevant strategic asset, threatening the permanent availability and operability of the strategic asset to comply with its applicable obligations, in particular the functions of public service, in the terms prescribed by law.

V TYPICAL TRANSACTIONAL STRUCTURES

i General environment

In view of the prohibition against discrimination based on nationality, when setting up a transactional structure in Portugal, there is no need to involve a domestic partner and there are no specific obligations for foreign investors; the treatment of foreign and domestic investment in Portugal is identical.

In addition to enjoying the same conditions and rights as domestic companies, foreign companies are liable for the same taxes and must also satisfy social security payment deadlines.

Regarding exchange control and currency regulations, the Treaty on the Functioning of the European Union establishes the free movement of capital within the European Union and therefore, as a rule, all restrictions on capital movements and payments between EU Member States are prohibited. There are no exchange controls or currency regulations affecting inbound or outbound investment; the repatriation of income, capital or dividends; the holding of currency accounts; or the settlement of currency trading transactions. However, there are separate restrictions relating to the provision of funds or dealing with the assets of certain individuals and entities (e.g., entities linked to terrorism or recognised terrorist organisations). As mentioned previously, temporary restrictions and sanctions have been imposed on the Russian Federation, the Belarus government, and entities and natural persons that support these regimes. Furthermore, the exclusion of Russian economic entities, such as payment institutions and banks, from the SWIFT system has disrupted cash streams and provided for an additional barrier when dealing with entities established in this economic area.

ii Setting up a business in Portugal

Foreign investors typically choose a transaction structure that allows them to invest directly in Portugal. The two most important structures involve the incorporation or acquisition of a subsidiary or the establishment of a branch. The choice between the two options is determined primarily on the basis of commercial reasons, given that the opening and registration costs involved, as well as the tax and accounting duties, are generally similar.

A subsidiary is an independent legal entity that may be incorporated under any of the structures established under Portuguese law.

The most frequently used structures are limited liability companies and public limited companies. Both limit the shareholders' liability for the company's obligations to the amount invested as share capital. A foreign investor's choice between a limited liability company and a public limited company primarily depends on the simplicity of the corporate and management structure, the investment to be made as share capital and any confidentiality issues surrounding shareholdings in the company.

The process of incorporating a company in Portugal was recently amended to simplify it. A company may be set up by means of a private document signed by the shareholders, whose signatures are certified by a notary or a lawyer, unless a more formal instrument is required to transfer the assets brought into the company (in which case a notarial deed must be executed). Registration with the Commercial Registry takes only a few days.

Establishing a branch

Any foreign corporation seeking to carry out activities in Portugal for a period longer than one year must arrange permanent representation in Portugal. If the activity has minimum material substance, that representation may be carried out through a branch. The branch is not deemed an autonomous legal entity and, consequently, the foreign company will be liable for all actions carried out by its local branch. The branch must have a representative with general managerial powers and be registered with the Commercial Registry.

iii Corporate law residency requirements

Under Portuguese law, a tax identification number is mandatory for both natural and legal persons, whether domestic or foreign, who hold obligations or intend to exercise their rights in relation to the tax authorities pursuant to Decree-Law 14/2013 of 28 January, as amended. A tax identification number is obtained by filing specific documentation with the tax authorities regarding residency in the country of origin and, in certain cases, by appointing a representative.

No tax issue should arise from an application by an individual who is not resident in Portugal for a Portuguese taxpayer number. In particular, obtaining a Portuguese taxpayer number does not imply that the non-resident individual will be taxed in Portugal as a Portuguese resident taxpayer, or that the individual will be subject to Portuguese income tax as a non-resident on income obtained abroad; the individual will be taxed in Portugal only on income considered to have been obtained within the Portuguese territory, if and when applicable.

VI OTHER STRATEGIC CONSIDERATIONS

i Securities law

Companies operating in Portugal or planning to enter the Portuguese market must take into consideration that the acquisition of a stake in a Portuguese company is subject to specific rules regarding disclosure of the stake held or, to some extent, to the duty to launch a mandatory takeover.[8]

A major reform took place at the beginning of 2022 with the entry into force of the new Portuguese Securities Code, the aim of which, among other things, is to simplify the issuance of securities in the regulated market, thus fostering its growth.

Securities Code

Disclosure duties

Any legal or natural person who acquires a direct or indirect holding that, in aggregate or with the shares already held, reaches, exceeds or falls below 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, one-third, 50 per cent, two-thirds or 90 per cent of the voting rights attached to the shares of an issuer admitted to trading on regulated markets located or operating in Portugal (i.e., having its shares or other equity securities listed in those markets) is required to notify the CMVM and said issuer of that fact.

The Securities Code requires the aggregation of voting rights attached to shares held directly by a shareholder and those held by certain related parties. The shareholder's notification to the CMVM and the issuer must include details of the voting rights held by third parties that have been attributed to that shareholder.

Mandatory takeovers

A legal or natural person who acquires more than one-third or half of the voting rights of a Portuguese public company must make an offer to acquire all the remaining shares and other securities issued by that company that grant rights to subscribe for or acquire shares (e.g., subscription rights issued in the context of a share capital increase). The launch of an offer is not required when, despite exceeding the threshold of one-third or half of the voting rights, the holder proves to the CMVM that it neither has control of the target company nor is involved with it in a group relationship. In addition, the obligation to make an offer may be waived by the CMVM if the thresholds are reached in the context of:

- a takeover bid for all the shares of the relevant company, as long as the rules relating to the consideration to be exchanged for the shares are satisfied;
- a financial restructuring plan within the scope of statutory reorganisation measures;
- a merger; or
- an inheritance or legacy.

ii Antitrust: merger control rules

Companies operating in Portugal or planning to enter the Portuguese market should take into consideration that a concentration between companies active in Portugal may be subject to mandatory merger control review by the corresponding competition authorities. This may entail an obligation to notify the AdC,[9] and therefore may also be subject to a suspension obligation (the standstill obligation)[10] until the operation is authorised. For that reason, merger control has a very significant role in establishing the expected timetable for a transaction and, from a contractual perspective, requires the inclusion of specific provisions regarding the possibility that the transaction may be subject to prior authorisation from the competition authorities.

For merger control purposes, both EU and domestic rules define a concentration as a transaction that implies modification of the control structure of the company on a long-term basis through:

- the merger of two independent companies;
- the acquisition of partial or sole control over a company or various companies, by any legal means or legal contract; or
- the creation of a joint venture and, in general, the acquisition of joint control over a company if the latter performs all the functions of an autonomous economic entity.

From a practical perspective, the competition authorities (including the AdC) have considered a wide range of transactions as concentrations for merger control purposes. Most of these transactions involve acquisitions of majority stakes in certain companies. However, the concept of 'concentration' also applies to other operations, such as the acquisition of assets (e.g., factories, commercial premises and even intellectual property), provided that these assets constitute an activity resulting in a market presence to which a turnover can be attributed, and even to agreements that do not involve a change of ownership. Furthermore, a change in the nature of control, from sole control to joint control or vice versa, is also relevant for merger control purposes and may constitute a concentration for competition purposes.

As elsewhere in the European Union, the Portuguese merger control system relies on the concept of 'control'. Only transactions that entail a change in the structure of control of an undertaking will constitute a concentration subject to merger control rules. In this regard, it is important to take into account that the veto rights conferred on minority shareholders may grant them control under the applicable merger control regulations. For instance, this will occur if they refer to:

- approval of the company's budget;
- approval of the business plan;
- the appointment of managers and directors;
- the appointment of the majority of the members of the board; or
- decisions about strategic investments.

Once the existence of a concentration is established, the Portuguese Competition Act (unlike the EU Merger Regulation and the laws of most Member States – except for Spain) establishes alternative turnover and market share notification thresholds.

Therefore, in short, undertakings must notify a concentration if any of the following conditions are met:

- the combined aggregate turnover in Portugal of all the undertakings exceeds €100 million, provided that the individual turnover in Portugal of each of at least two of the undertakings concerned exceeds €5 million;
- the concentration results in the acquisition, creation or increase of a market share in Portugal equal to or greater than 50 per cent; or
- the concentration results in the acquisition, creation or increase of a market share in Portugal equal to or greater than 30 per cent but less than 50 per cent, provided that the individual turnover in Portugal of at least two of the undertakings concerned exceeds €5 million.

If a transaction has an EU dimension, the European Commission will have exclusive jurisdiction over the merger and, in principle, the Portuguese merger control procedure will not apply. In this regard, the EU Merger Regulation[11] establishes the thresholds[12] that trigger the obligation to notify the Commission. Nevertheless, the issue must be analysed in each case depending on the market affected by the transaction.

In this context, when a transaction qualifies as a concentration from a competition standpoint and meets one of the notification thresholds, it will be subject to both the prior notification obligation and the standstill obligation. The parties are then obliged to notify the AdC or the European Commission and are obliged to suspend the implementation of the concentration until the AdC has issued a clearance decision and until the real closing of the operation. In exceptional circumstances, the AdC, like the Commission, can grant a waiver from the standstill obligation if the acquirer can demonstrate that serious harm will arise from the suspension and that no competition law concerns are expected.[13] Derogation of this kind is relatively rare and is normally considered only if the target is facing serious financial and structural difficulties that threaten its viability.

Otherwise, a breach of these obligations (notification and standstill), which qualifies as 'gun-jumping', entails a fine of up to 10 per cent of the turnover of the undertaking in breach. Under the Portuguese Competition Act, members of the board of directors of the infringing undertakings, as well as any individuals responsible for managing or supervising those individuals, could also be sanctioned for gun-jumping, especially when directly involved in an unlawful decision not to file a notification or to breach a standstill obligation. The fine imposed on individuals cannot exceed 10 per cent of the individual's annual income deriving from the exercise of their functions in the undertaking concerned.

Additionally, during the past few years, there have been wide-ranging discussions about the adequacy of the existing merger control tools in the European Union and worldwide to capture and sufficiently assess the concentrations that could significantly impede effective competition. These discussions are starting to materialise at the EU level and are having a direct impact in Portugal. For instance, the guidance issued by the European Commission on the application of the referral mechanism set out in Article 22 of the EU Merger Regulation[14] aims at ensuring the review by the Commission, through referrals by Member States, of certain transactions that otherwise would escape merger control by falling below the relevant and existing thresholds. Even though the AdC has not yet used this mechanism, this new position necessarily has a relevant effect at a national level, requiring the careful assessment of any transaction that, although not meeting the national or EU notification thresholds, could justify being subject to merger control. This could end up introducing more uncertainty for businesses, increased costs, potential delays to closing and increased burdens in the drafting of the transaction documents.

In parallel, and further to the health and financial crises caused by covid-19, the AdC has spent time evaluating options to strengthen competition regimes, with a special focus on innovation. The AdC drew attention to the importance of promoting innovation towards a better and more sustainable economic recovery. Making the protection and incentives for innovation one of its priorities for 2021 and again in 2022, the AdC considers that the removal of structural and legislative barriers that impede innovation, efficiency and growth contribute to a greater level of competitiveness between companies.[15] This increasing attention to innovation concerns is leading to more sophisticated substantive assessment in merger control proceedings, namely for more importance to be given to the effects of the merger in terms of reducing choice and harming innovation. Thus, we can undoubtedly expect further developments in the near future, and undertakings must remain vigilant for new rules and, especially, new enforcement approaches.

In 2023, the AdC also reiterated its focus on intensifying the enforcement of competition rules.[16] In particular, in the field of merger control, the AdC confirmed its intention to continue monitoring more closely merger activity to identify those transactions that fail to comply with the prior notification obligation or are implemented prior to approval (i.e., gun-jumping, mentioned above). To this end, in December 2022, the AdC issued the Best Practices Guide on Gun-jumping.[17]

The AdC has given increasing importance and attention to gun-jumping cases, imposing more severe fines. Between 2019 and 2022, the AdC opened more than 10 investigations for alleged merger implementations without prior authorisation from the AdC and issued at least five sanctioning decisions[18] relating to this class of infringement. In 2022, the AdC sanctioned Santa Casa da Misericórdia de Lisboa over its acquisition of CVP – Sociedade de Gestão Hospitalar for failing to notify the merger, with the highest fine ever for this type of conduct: €2.5 million.[19] Before this, the AdC had issued only two sanctioning decisions, with minor fines.

iii Anti-commercial bribery law

Various acts are criminalised by the Portuguese Criminal Code to prevent corruption in both the public and private sectors.

The concepts of corruption and bribery can have different connotations in different countries and are often used interchangeably. For the purposes of this summary, the concept of corruption is used to describe the broader phenomenon of dishonest conduct. As such, it includes the narrower concept of bribery, understood as the act of providing (or receiving) an advantage to obtain (or perform) a favoured treatment.

The Criminal Code distinguishes between acts of passive bribery (generally, the act of receiving an advantage in exchange for a certain action) and active bribery (providing an advantage to someone to receive favourable treatment) committed in both the public and private sectors.

VII OUTLOOK

The aim of the government's economic recovery plan for the next 10 years, entitled Strategic Vision for Portugal's Economic Recovery Plan 2020–2030,[20] is to reactivate the Portuguese economy; a set of guidelines and recommendations is being established to achieve this. Further economic development is expected, with a projected growth (to 2030) of 2.68 per cent.[21]

In terms of relevant legislative innovations, a Banking Activity Code is currently undergoing the legislative process, having already ended its public consultation phase. The main goal of this regulation is to concentrate and clarify the regime applicable to banking activity and to reinforce the supervisory powers of the Bank of Portugal over banks carrying out business in Portugal.

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Endnotes

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2 Directive (EU) 2019/1 of the European Parliament and of the Council of 11 December 2018 to empower the competition authorities of the Member States to be more effective enforcers and to ensure the proper functioning of the internal market, OJ L 11, 14.1.2019, pp. 3–33.
3 The Portuguese Competition Act was most recently revised in 2012 with Law 19/2012 of 8 May 2012 and further amended in 2021 by Decree-Law 108/2021 and in 2022 by Law 17/2022.
4 Decree-Law No. 138/2014 of 15 September.
5 Nevertheless, the Constitutional Court has already held, with general effect, that a holding company's liability, at least in connection with labour matters, cannot be excluded solely on the basis that its registered office is located abroad.
6 Law 27/2007 of 30 July implementing Council Directive 89/552/EEC of 3 October 1989 on the coordination of certain provisions laid down by Law, Regulation or Administrative Action in Member States concerning the pursuit of television broadcasting activities – 'Television without Frontiers', as amended.
7 Decree-Law 138/2014 of 15 September.
8 As previously mentioned, applicable merger control rules must also be observed.
9 Autoridade da Concorrência.
10 Significant fines could be imposed – up to 10 per cent of the worldwide turnover of the company – and even the validity of the agreement challenged, if the suspension obligation is not met.
11 Council Regulation (EC) No. 139/2004 on the control of concentrations between undertakings.
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Chapter 19

Saudi Arabia

Suhaib Hammad and Ebaa Tounesi[1]

Summary

I OVERVIEW

Saudi Vision 2030, launched in 2017, implemented major reforms to incentivise foreign investors in Saudi Arabia with respect to promoting direct investment, neutrality and fairness. The Saudi Ministry of Investment (MISA) was established in 2000 and on 5 April 2022[2] it published the new Investment Law for public consultation. The new Law, which will further promote equal opportunities for foreign and local investors in Saudi Arabia, is currently in its draft form and subject to potential changes following the public consultation and, as such, it will not be addressed in detail in this chapter.

Saudi Arabia's current goals align with MISA's foreign direct investment strategies to increase capital sources, as well as access to management expertise, jobs and entry to new markets within the different regions of Saudi Arabia. MISA further aims to regulate the requirements and process of investing in Saudi Arabia, along with regulating the rights and obligations of investors in Saudi Arabia. There are, nevertheless, certain restrictions that limit foreign businesses from conducting certain types of activities in Saudi Arabia, such as higher capital requirements for foreign entities. To overcome further challenges associated with encouraging foreign investors in Saudi Arabia, MISA has imposed different investment principles and policies to maintain high standards and transparency between foreign and local investors, as well as issuing investment strategies to identify key benefits, sectors and entities to maximise opportunities and business profitability for foreign investors in Saudi Arabia.

Under the current regime, the Foreign Investment Law, promulgated by Royal Decree No. M/1 of 10 April 2000, and its implementing regulations regulate the requirements and process of investing in Saudi Arabia.[3] Foreign investors must acquire an investment licence from MISA, and the type of licence required will depend on the type of business activity the investor intends to carry out in Saudi Arabia. MISA has provided a comprehensive investment manual, specifying the steps and requirements for obtaining the MISA investment licence for various business activities such as service activities, industrial and manufacturing activities, real estate, and retail or wholesale activities, all of which require different investment licences. This process has been digitised in recent years and may now be completed electronically through the MISA website. This has facilitated the growth of investment in several industries, including, without limitation, wholesale and retail trade, construction, manufacturing, accommodation and food and beverage, and information technology.

Moreover, considering that the foreign investment regime is constantly evolving to offer a range of opportunities in Saudi Arabia, there is an ongoing demand to ensure that efficient measures are in place to combat unlawful foreign investment and fraudulent activities in Saudi Arabia; for example, the Anti-Concealment Law, promulgated by Royal Decree No. M/22 of 22 June 2004, regulates the acts of foreign investors unlawfully operating by means of commercial concealment arrangements in Saudi Arabia.[4] Additionally, the new Investment Law is one of several measures proposed recently to improve the legal landscape of foreign investment in Saudi Arabia by promoting fairness and impartiality between local and foreign investors. In this regard, and in line with other governmental authorities, MISA has established several additional platforms to promote and provide guidance to foreign investors, which will be explained in further detail below.

II YEAR IN REVIEW

MISA issued a draft of the new Investment Law and made it available for public review and consultation from 5 April 2022 to 5 May 2022.[5] The draft law was prepared pursuant to (1) Royal Court Telegram No. 16917 of 5 December 2018,[6] which stipulated that MISA shall review the statutory provisions relating to investment to ensure alignment with Saudi Vision 2030 and international best practice to promote and encourage foreign and local investments, achieve economic diversification and increase domestic product; and (2) the National Investment Strategy promulgated by Council of Ministers Decision No. 134 dated 5 September 2021,[7] which provides for an initiative to establish an integrated system for investment in line with Saudi Vision 2030 and the National Investment Strategy objectives to replace the current Foreign Investment Law. The draft has yet to be enacted and the current

Foreign Investment Law remains in effect. The draft law aims to enhance the investment regime in Saudi Arabia and to preserve foreign investors' rights. The key objectives of the draft law include facilitating and protecting the entry procedures for foreign investors and supporting the principle of competitive neutrality and fairness and ensuring equal opportunities in the treatment of foreign direct investments made by public and private investors. In this regard, the most distinctive objective of the draft is standardising the rights of foreign investors with those of Saudi investors and promoting equal treatment.

Another notable development pursuant to Council of Ministers Resolution No. 377 of 27 December 2022 is that foreign businesses without regional headquarters (RHQs) in Saudi Arabia may not be able to contract with Saudi governmental (or semi-governmental) entities or agencies, unless under certain circumstances, which will come into effect on 1 January 2024.[8] MISA has issued further guidance and requirements on the Regional Headquarters Program, which aims to incentivise foreign investors to set up their RHQs in Saudi Arabia by obtaining an RHQ business licence. This decision aims to minimise tax leakage and promote foreign direct investment in Saudi Arabia, as well as increasing employment rates.

Furthermore, the General Authority of Civil Aviation recently rolled out the Special Integrated Logistics Zone (SILZ), the first special economic zone (SEZ) in Saudi Arabia, pursuant to Royal Order No. A/17 of 10 October 2018. [9] All investors wishing to incorporate in SILZ may apply directly to SILZ's department, which maintains a special registry of companies incorporated in accordance with the SILZ companies law. SILZ also offers foreign investors flexibility in employment, 50-year tax relief, suspension of import restrictions and customs duties, and VAT exemption for goods under customs suspensions. This is an attractive option for investors in the logistics field desiring to offer services and products within the region and globally. Other SEZs will be overseen by the Economic Cities and Special Zones Authority (ECSZA), pursuant to Royal Order No. A/19 of 24 February 2010.[10] Furthermore, ECZCA has recently announced the establishment of four additional SEZs: (1) King Abdullah Economic City SEZ; (2) Ras Al-Khair SEZ; (3) Jazan SEZ; and (4) Cloud Computing SEZ. Each zone caters to a specific industry, such as supply chain and logistics, shipbuilding, metal conversion and cloud computing, respectively. These ECSZAs will also have their own special registry of incorporated companies, along with a separate companies law and employment law distinct from mainland Saudi laws. Such recent developments offer investors several attractive options for foreign direct investment while protecting their interests in the Saudi market.

III FOREIGN INVESTMENT REGIME

i Policy

All foreign investments and involvements in Saudi Arabia are subject to review. Launched and approved by the Council of Ministers, the Permanent Ministerial Committee for Examining Foreign Investments (CEFI) studies and examines all transactions involving a foreign element to better govern their direct and indirect impact on national security and their compliance with public policy. The CEFI is responsible for issuing policies, guidelines and penalties as applicable. Additionally, MISA oversees the involvement of foreign investors through its regulations and registration procedures, screening them to ensure their eligibility and compliance with the implementing regulations of the Foreign Investment Law. These regulations stipulate conditions to be satisfied for the issuance of a licence, including: (1) the products or services concerned must be in compliance with Saudi law; (2) applicants must be a legal entity or a natural person coming to Saudi Arabia for investment purposes; (3) investors must not have previously breached the Saudi Foreign Investment Law; (4) investors must not have been convicted of any commercial or financial crimes in the past, either in Saudi Arabia or elsewhere; (5) the granting of the licence must not be in breach of any international agreement to which Saudi Arabia is a party; and (6) the investment activities must not be on the Negative List of activities excluded from foreign investment in Saudi Arabia.

ii Laws and regulations

As explained, foreign investment in Saudi Arabia is governed by MISA and the Foreign Investment Law (and its implementing regulations), in addition to other laws regarding the operation of the entity concerned and its interaction with the individuals, employees and different governmental authorities. These laws include, among other sector-specific laws, the Companies Law, the Labour Law, the Social Insurance Law, the Income Tax Law, the Bankruptcy Law, the Competition Law and other Gulf Cooperation Council laws specific to certain sectors. Each of the aforementioned laws is enforced by the relevant sector-specific authority; therefore, all tax-related laws are enforced by the Zakat, Tax and Customs Authority under the auspices of the Ministry of Finance, whereas the Companies Law is enforced by the Ministry of Commerce and the Labour Law is enforced by the Ministry of Labour, and all judicial procedure laws fall within the remit of the Ministry of Justice.

iii Scope

In accordance with Decision No. 83 of 7 September 2021, the CEFI screens strategic sectors to identify any direct and indirect impact of investments on national security and public order.[11] This is particularly relevant with respect to any potential investment within the defence sector, which is subject to strict screening and security clearance by the local authorities. The CEFI monitors direct and indirect foreign ownership and any securities and share warrants that are convertible into capital in any entities wholly owned by a foreign investor and entities jointly owned by a foreign investor and a Saudi national. The CEFI has yet to publish any guidelines or procedural and operational restrictions. The scope of both the screening and transactions subject to foreign investment examination are wide and include any direct and indirect involvement in any entities, whether wholly foreign-owned or jointly established with a Saudi national, including any mergers, acquisitions and joint ventures.

iv Voluntary screening

The CEFI's main objective is to monitor strategic areas of foreign investment and identify activities that may affect national security or public order. Therefore, foreign investments within certain sectors will be subject to assessment and potential restrictions. Article 3 of the Foreign Investment Law authorises the Saudi Economic and Development Affairs Council to list prohibited foreign investment activities; however, following its creation, the CEFI has imposed additional obligations in relation to prohibited activities by identifying industries sensitive to national security, publishing procedures and regulations for screening foreign investments, and creating a list of sanctioned entities. Therefore, the CEFI has the authority to exclude or limit foreign investment in the event that it determines that the investment will affect the local public policy in Saudi Arabia.

v Procedures

In accordance with Article 2 of the Foreign Investment Law, the overseeing authority must act on the investment application within 30 days of the submission of all documents required by the regulations. In the event that the authority rejects the application within the prescribed period, the foreign investor shall have the right to appeal the decision. Furthermore, Article 12 of the Foreign Investment Law stipulates that investors who are in violation of the Foreign Investment Law or its implementing regulations may be subject to the following penalties: (1) the withholding of all or some of the incentives given to foreign investors; (2) the imposition of a fine not exceeding 500,000 Saudi riyals; and (3) revocation of the investor's foreign investment licence. The foreign investor may appeal a penalty resolution before the Board of Grievances in Saudi Arabia.

vi Prohibition and mitigation

Generally, MISA does not disclose to the public details of any prohibited or rejected applications of foreign investors. However, because of the acceleration of foreign investment activities within Saudi Arabia, overseeing authorities are imposing stringent requirements for foreign investment standards. Depending on the sector of investment, most prohibitions relate to violations of the applicable regulations within Saudi Arabia, ensuring that the investor is reputable, in compliance with shariah laws, has sufficient solvency and has not previously failed to meet any financial obligations towards creditors, as well as being in compliance with anti-money laundering and counterterrorism financing policies and regulations.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

MISA updated its latest Negative List in 2022, which stipulates the sectors prohibited for foreign investors and outlines the specific activities and licences. The Negative List further specifies the activities restricted in the industrial sector, which include oil drilling, production and exploration, except those incidental services relating to the mining sector. The service sector restrictions are wider and include real estate investment in Makkah or Madinah, tourist orientation and guidance services relating to Hajj and Umrah, recruitment and employment services, including local recruitment offices, commission agents, security and detective services, catering to military sectors and fisheries.

ii Restricted sectors

In addition to prohibiting investment in certain sectors, MISA has restricted certain licences with minimum capital or Saudi participation. The restrictions vary depending on the regulated activity and the corresponding MISA investment licence. For example, 100 per cent foreign-owned trading MISA licences require a minimum capital of 30 million riyals, while the capital requirement for a mixed (Saudi and foreign) trading MISA licence is lower, at 26.6 million Saudi riyals, with a foreign capital shareholding of not less than 20 million Saudi riyals; therefore, the minimum Saudi participation percentage is 25 per cent. Additional licences restricted by both capital and Saudi participation include property financing and public transportation. The restrictions on property financing include minimum capital of 200 million Saudi riyals and 40 per cent minimum Saudi participation.

Furthermore, various governmental agencies regulate and have jurisdiction over the different activity-specific operational licences needed, such that operations and requirements are supervised by the relevant ministry or authority. These government agencies and the corresponding sectors include the Saudi Central Bank, which is responsible for the financial services sector and the insurance sector in Saudi Arabia, the Saudi Food and Drug Authority, which regulates pharmaceuticals and medical equipment and products, and the Communications and Information Technology Commission, which oversees the information and communications technology sector in Saudi Arabia.

V TYPICAL TRANSACTIONAL STRUCTURES

i Corporate legal residency requirements

In Saudi Arabia, joint-stock companies (JSCs) are managed by a board of directors, and limited liability companies (LLCs) are managed by a minimum of one manager or, alternatively, a board of managers. Appointed managers may be either Saudi nationals or non-Saudi nationals; however, non-Saudi managers are required to obtain a residency permit to carry out daily management activities and to register with the relevant government bodies and deal with, and be the signatory for, the bank account. Notably, foreign companies may appoint a board of managers with a mix of Saudi and non-Saudi nationals. A Saudi governmental relations officer must also be appointed by the foreign company and registered with governmental bodies in the event that all the appointed managers are non-Saudi.

ii Takeover bids

The rules pertaining to takeover bids in Saudi Arabia include, but are not limited to, several factors: (1) tax considerations; (2) foreign investment restrictions; (3) merger control; (4) intellectual property rights; and (5) employment considerations.

The foreign investor and the target company should also appoint an accredited independent financial adviser, along with an independent legal adviser, to obtain proper advice on the potential takeover. Generally, the buyer will carry out a due diligence assessment of the target company by obtaining documents relating to material contracts, financial matters, litigation, tax, intellectual property and data protection compliance. In this way, the bidder will conduct a due diligence assessment of the target's compliance with the above-mentioned commercial aspects of the target's business.

iii Asset and share purchases

Share purchase

Once the outcomes of the legal and financial due diligence reports are satisfactory to the acquiring entity, the contracting parties need to undergo negotiations to execute a share purchase agreement (SPA) to govern the sale and purchase of shares. The SPA is the conclusive agreement in the sale of targeted assets and shares. Such an agreement stipulates the terms of the transaction, identifying the respective parties' obligations, rights and liabilities (if any), and creates a contractual protection from any undisclosed risk or liability of any party.

There is no specific mandatory legal form for an SPA in Saudi Arabia. SPAs are generally drafted and structured in a way that includes terms and conditions associated with the following clauses:

- identifying the contracting parties;
- background information on the acquisition transaction;
- definitions;
- details of the shares and assets relating to the acquisition;
- consideration and price of the assets or shares;
- transactions;
- the acquisition transaction method and how it will occur;
- indemnities, warranties and remedies;
- conditions precedent;
- confidentiality;
- tax provisions;
- governing law; and
- dispute resolution.

As there is no specific form for drafting the SPA, this is not an exhaustive list of clauses but rather the most common and most important clauses when purchasing shares.

Asset purchase

Asset purchases are distinct from share purchases in that the buyer can be flexible in determining the assets and, to a certain degree, excluding liabilities. Certain considerations must be taken into account when pursuing an asset purchase in Saudi Arabia and, initially, the investor must establish a licensed entity prior to concluding any acquisitions. In the event that the asset subject to purchase (e.g., a factory or plant) is owned by a foreign entity, the investment licence and commercial registration are to be amended to reflect the new owner, along with the articles of association, which must be notarised before a Saudi notary public or the competent authority's representative. Upon amending and updating the incorporation documents, the parties will be required to execute a sale and purchase agreement.

Key differences

A share purchase is less time-consuming to execute and is more common in Saudi Arabia; however, note that when purchasing shares, any liability of the targeted shares is inherited, regardless of whether or not these liabilities have been disclosed. Therefore, a higher level of due diligence is required when purchasing shares or when involved in a sale of shares. Additionally, purchases of shares include certain rights attached to the shares where those rights would normally be guaranteed by buying or having shares in the company. These rights are attached to the shares and cannot be restricted, including the right to attend shareholders' meetings and to vote on company resolutions; the right of first refusal in buying the shares of an existing shareholder; the right to receive dividends, financial statements and managers' reports; the right to appoint or remove board members; and the right to access and review the company records.

iv Joint ventures

Joint ventures can be an attractive method of investment in Saudi Arabia for foreign investors as these are commonly used in all sectors in Saudi Arabia. Equity joint ventures are commonly used as a means to gather resources for large-scale projects, as foreign businesses rely on equity joint ventures with Saudi Arabian parties to acquire local connections and expertise. Furthermore, Saudi Arabia also offers incentives to foreign investors, such as favourable financing conditions for joint ventures involved in manufacturing and industrial projects through the Saudi Industrial Development Fund.

Minority investor protection in Saudi Arabia is currently somewhat primitive in that it lacks proper legislative safeguards for foreign investors. However, protection exists in that a qualified majority is required for certain decisions. For instance, amending the articles of association under an LLC, changing the capital, extending the company's term, liquidating the company or merging the company under a JSC requires approval by 75 per cent of the shareholders. Minority investors seeking to ensure their own protection in a Saudi entity are advised to include specific appropriate provisions such as increasing the statutory minimum to 100 per cent of the shareholders' approval, within the joint venture agreement. Additionally, the new Companies Law promulgated by Royal Decree No. M/132 dated 01/12/1443 H (corresponding to 30/06/2022 G) has introduced protections for minority investors, such as tag-along rights.[12] Upon the majority shareholder's transfer of shares to a third party, the minority shareholder may obligate the majority shareholder to include the minority shareholder's shares in the sale of shares for the same value and conditions offered by the third party to the majority shareholder.

There are further restrictions that may impact foreign investors and joint ventures operating in Saudi Arabia, particularly with regard to the application of shariah law and financing, whereby loans, interest rates and conventional financing are not permitted in Saudi Arabia. These can, nevertheless, be somewhat mitigated through proper structuring and operation of the joint venture.

v Other corporate structures for ownership

The main corporate structures in Saudi Arabia include LLCs, JSCs, simplified JSCs and branches of a foreign company, with the main aspects of each form of entity, and advantages and disadvantages associated with each form, provided in detail below.

LLCs

LLCs are the most common type of legal form adopted in Saudi Arabia because of the simple incorporation steps and fees, as an LLC does not have a minimum capital requirement (subject to any minimum capital requirement stipulated by the relevant MISA investment licence). The share capital of a foreign LLC must be fully paid up following incorporation and may be managed by a board of managers, a single general manager or two general managers. It may also be owned by a single shareholder. The main feature of an LLC is that the liability will be limited to the individual shareholder's share in the capital; therefore, shareholders are not held liable for any of the liabilities imposed on the company.

JSCs

JSCs can be either a public JSC (listed) or a closed JSC (unlisted) and are subject to higher supervision by the Ministry of Commerce and the Capital Market Authority. Establishing a JSC entails higher costs, lengthier incorporation periods and stricter compliance requirements. JSCs allow the company to have an authorised share capital and an issued share capital. All JSCs must have a minimum capital of 500,000 Saudi riyals, which must be fully paid within five years of incorporation, with 25 per cent of this to be paid at the time of incorporation. Additionally, JSCs must be managed by a board of directors consisting of at least three members. Furthermore, as with LLCs, the liability of a JSC is also limited to its share ownership.

Simplified JSCs

The new Companies Law introduced a new form of legal entity, the SJSC, as a recognised legal form in Saudi Arabia that offers flexibility to investors by combining the main features of both LLCs and JSCs. Investors (1) may structure the company's management in any desirable method, such as by a single manager, two managers or a board of managers; (2) are not restricted to a minimum capital requirement; (3) may state both an authorised and issued share capital; (4) may issue different classes of shares (being ordinary shares, preferred shares or redeemable shares); (5) may enforce certain restrictions or conditions on the transfer of shares, such as including a 'lock-in' period or imposing conditions under which a shareholder is obligated to transfer their shares; and (6) are protected from liability, as the liability is limited to the shareholders' share ownership in the company.

Branches of foreign companies

Branches of JSCs or LLCs are regarded as extensions of the parent company and do not create a separate legal entity. The parent company is therefore exposed to risks and all liabilities that the branch may be subject to. However, the requirements are more lenient than forming an LLC, as the incorporation process does not require drafting new articles of association, nor does it impose a minimum capital requirement. This form is usually adopted by entities that contract with local companies directly through their overseas business and subsequently establish a branch to perform the same activities in Saudi Arabia, thereby meeting their obligations in accordance with the agreement between the parties.

VI OTHER STRATEGIC CONSIDERATIONS

Mergers

Foreign investors must obtain approval from the General Authority for Competition (GAC) in the event of a takeover (whether through a merger or an acquisition of shares), in accordance with the provisions of the Competition Law. GAC, in accordance with the Competition Law, supervises economic concentration transactions in Saudi Arabia. Economic concentration is when a merger or an acquisition (or both) takes place and ownership is transferred in the course of acquiring the target assets, shares, interests, rights or obligations. GAC assesses the prospective economic concentration prior to any transactions of this kind. GAC must be notified within (at least) the 90 days prior to the closing of an acquisition transaction where that acquisition would result in the acquiring party being in a dominant position (having 40 per cent of the market share in the region is considered a dominant position in the market) or where the total annual sales of all parties involved in the acquisition (up to the level of the ultimate beneficial owners of both parties) exceed 100 million Saudi riyals.

VII OUTLOOK

In terms of Saudi Vision 2030, the primary goals are to increase sources of income and encourage foreign investors to participate in a range of investment activities throughout Saudi Arabia. This is reflected in the implementation of rules and legislation to ensure that Saudi Arabia's goals are reached while preserving foreign investor rights. The new Investment Law will impose the same approval requirements for both local and foreign investors with respect to business activities and licence and permit requirements. There will be further provisions imposing heavy fines for any violations of the new Investment Law or its implementing regulations. Under the new Investment Law, foreign investors will be free to manage, sell or otherwise dispose of their investment projects, ensuring that foreign investors can expand their operations with ease and eliminating any commercial barriers that were previously in place.

Furthermore, in line with the National Investment Strategy, which aims to boost foreign investment streams to over US$100 billion by 2030, the Saudi Green Initiative was launched to create investment opportunities in the field of sustainability. Foreign investors are also incentivised to establish their RHQs and further utilise the SEZs established in Saudi Arabia to obtain tax incentives aimed at encouraging and attracting international investors to enter the Saudi market.

Investment in Saudi Arabia has increased rapidly over the past few years, and its impact on the economy has prompted local authorities to implement programmes, policies and regulations to further promote business continuity and expansion of small and medium-sized enterprises, in line with Saudi Vision 2030. The competent authorities will continue to implement regulations and policies to ensure that stringent measures are in place to improve foreign investment confidence throughout Saudi Arabia.

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Endnotes

1 Suhaib Hammad is a partner and Ebaa Tounesi is a mid-level associate at Hammad & Al-Mehdar Law Firm.
2 Corresponding to 04/09/1443 in the Hijri calendar (H). Dates are presented using the Gregorian calendar except where stated.
3 Corresponding to 05/01/1421H.
4 Corresponding to 04/05/1425H.
5 Corresponding to 04/09/1443H until 04/10/1443H.
6 Corresponding to 27/03/1440H.
7 Corresponding to 28/01/1443H.
8 Corresponding to 03/06/1444H.
9 Corresponding to 10/02/1440H.
10 Corresponding to 10/03/1431H.
11 Corresponding to 30/01/1443H.
12 Corresponding to 01/12/1443H.

Chapter 20

South Africa

Deon Govender and Sibusiso Ngwila[1]

Summary

I OVERVIEW

According to the World Bank, South Africa's foreign direct investment (FDI) inflows for 2022 were approximately US$9 billion. This is a significant decrease from the FDI inflows of just over US$38 billion reported in 2021. In addition to global disruptions such as the Russia–Ukraine conflict, FDI inflows to South Africa in 2022 were severely impacted on by state-owned utilities' inability to render the electricity, transportation and logistics services essential for spurring FDI in the country's key economic sectors, including mining, construction and communications.

In an effort to address the aforementioned transportation and logistics services challenges and facilitate greater local investment and FDI for the country, Transnet (the state-owned freight logistics company) launched a bid process for 16 freight rail slots between the country's key cities. During the year under review, Transnet also shortlisted international and local bidders for private sector participation in two of the country's busiest container terminals. These initiatives are seen as being both necessary to address the country's pressing infrastructure needs and forerunners in South Africa's reintroduction of a privatisation programme. There were also key regulatory reforms to the electricity generation sector designed to drive more direct investment into that sector.

II YEAR IN REVIEW

Although various provisions of the Competition Amendment Act of 2018 were brought into force by the President of the Republic of South Africa in July 2019 and February 2020, the President is yet to bring into force the provisions of that Act introducing national security considerations into the assessment of foreign mergers. Those amendments, when in force, will oblige the country's President to establish a foreign investment committee to consider and, where appropriate, block proposed acquisitions of South African businesses by foreign acquiring firms if, in the view of that committee, the implementation of the merger might have an adverse effect on the country's national security interests. A foreign acquiring firm is defined as one incorporated, established or formed under the laws of a country other than South Africa or whose place of effective management is outside South Africa. The amendment expressly prohibits South Africa's competition authorities from approving a merger in instances where the foreign investment committee has blocked the implementation of the merger.

III FOREIGN INVESTMENT REGIME

i Policy

The South African government encourages FDI and has acknowledged that foreign investment is necessary to support the country's growth and development objectives. This has been manifest in the relatively fewer FDI approvals and the incentives available to foreign investors intent on establishing new enterprises in designated sectors. However, the South African government requires that the benefits of FDI be balanced against its costs to the South African economy.

For this reason, public interest considerations, which are generally embedded in licences and state tenders, are increasingly serving as criteria for the approval or rejection of foreign investment in the country. Public interest considerations are varied, including the need to protect jobs, promote localisation and enhance the ability of small businesses or firms controlled or owned by historically disadvantaged persons to become competitive. 'Historically disadvantaged persons' refers to black South African citizens, by virtue of their disenfranchisement during apartheid South Africa, as well as female and disabled South African citizens. Public interest considerations also have a bearing on mergers and acquisitions regulated by the Competition Act of 1998, irrespective of whether those transactions involve a foreign acquiring firm.

The South African government facilitates the advancement of historically disadvantaged persons through the promotion of Broad-Based Black Economic Empowerment (B-BBEE).

B-BBEE is a socio-economic programme endorsed by the Constitution. It is designed to redress the inequalities of apartheid through transformative measures that enhance participation by black people (and certain other designated groups of South Africans) in the South African economy. The legislature has prescribed a narrow meaning for what constitutes a 'black person' for the purposes of B-BBEE in the Broad-Based Black Economic Empowerment Act of 2003 (B-BBEE Act). That Act provides that a 'black person' is a person of African, coloured or Indian descent who is a citizen of South Africa by birth or descent, or who became a citizen of South Africa by naturalisation before 27 April 1994, or on or after that date, provided that the person would have been entitled to acquire citizenship by means of naturalisation prior to 27 April 1994.

ii Laws and regulations

The principal law governing foreign investment in South Africa is the Protection of Investment Act of 2015 (the Investment Act), which defines 'investment' within the context of FDI widely as:

- any lawful enterprise established, acquired or expanded by an investor in accordance with the laws of the Republic of South Africa, committing resources of economic value over a reasonable period in anticipation of profit;
- the holding or acquisition of shares, debentures or other ownership instruments of such an enterprise; or
- the holding, acquisition or merger by such an enterprise with another enterprise outside the Republic to the extent that the holding, acquisition or merger with another enterprise outside the Republic has an effect on an investment contemplated under points (a) and (b), above, in the Republic.

The Immigration Act of 2002 (the Immigration Act) provides for foreign investors to obtain a business visa to allow for them to lawfully enter the Republic for the purposes of investing in and carrying on a business. A business visa may be obtained from the South African Department of Home Affairs in terms of Section 15 of the Immigration Act, provided that the applicant for the visa is intending to establish or invest in a business within the Republic or has done so already. Business visas are granted for a period not exceeding three years at a time.

iii Scope

The Investment Act does not compel a review of inbound foreign investment, irrespective of the nature of the investment proposed. However, as noted above, the Competition Amendment Act (which was passed in 2019) permits the blocking of a merger involving a foreign acquiring firm if, in the view of a President-appointed foreign investment committee, its implementation is a cause for concern for the national security of the country. Unlike mergers and acquisitions, there is no review of new businesses established by foreign investors or joint ventures formed by foreign investors.

The Immigration Act requires that an applicant for a business visa must invest the prescribed financial or capital contribution into the relevant business, and that contribution must form part of the intended book value of the business. The prescribed financial or capital contribution is determined by the Minister of Home Affairs by a notice in the Government Gazette. The applicable financial contribution in 2022 was 5 million rand,[2] and the capital contribution must be in the form of new machinery and equipment. Notwithstanding the foregoing, the Immigration Act allows for the Director General of the Department of Home Affairs to reduce or waive the financial or capital contribution requirements in instances where the nature of the business of the applicant is prescribed to be in the national interest.

The types of business activities that the Minister of Home Affairs considers to be within the national interest during the year under review include:

- agro-processing;
- business process outsourcing and information technology-enabled services;

- capital and transport equipment, metals, and electrical machinery and apparatus;
- textiles, clothing and leather;
- electrotechnical (this includes, for example, advanced telecommunications, software development and smart metering);
- green economy industries (including power generation and renewable energy);
- oil and gas; and
- mineral benefaction and infrastructure development.

Moreover, an applicant for a business visa must ensure (or prove, if they have already invested or established the business, that they have ensured) that the business is duly registered with the South African Revenue Service and other prescribed government authorities and relevant professional bodies, boards or councils. No less than 60 per cent of the staff permanently employed within the applicant's business must be South African citizens or permanent residents. The Immigration Act allows for an application for a business visa to be refused if the industry in which the business operates is considered to be 'undesirable'. The Minister of Home Affairs issues a list of such industries from time to time, by notice in the Government Gazette. The industries that are currently considered undesirable are:

- businesses that import second-hand motor vehicles into the Republic for the purpose of exporting to other markets outside the Republic;
- the exotic entertainment industry; and
- the security industry.

For an application for a business visa to be approved, the applicant is also required to procure a letter of recommendation from the Department of Trade, Industry and Competition regarding the feasibility of the business and its contribution to the national interests of the Republic.

iv Voluntary screening

There are no procedures for a filing of a voluntary screening of a transaction that entails FDI in South Africa.

v Procedures

The Competition Act, as amended, does not make provision for the appeal of a decision by a foreign investment committee. However, a foreign acquiring firm that is aggrieved by the decision of a foreign investment committee may apply to the competent high court for a review of the committee's decisions under the terms of the Promotion of Administrative Justice Act of 2000.

vi Prohibition and mitigation

The amendments to the Competition Act permit the blocking of a merger involving a foreign acquiring firm if, in the view of a foreign investment committee, its implementation poses concerns for the national security of the country. Although the President is yet to identify and publish a list of national security interests that a foreign investment committee must consider, the amendments to the Competition Act provide that the President, when determining what constitutes national security interests for the purposes of that Act, must take into account all relevant factors, including the potential effects of a merger transaction:

- on the country's defence capabilities and interests;
- on the use or transfer of sensitive technology or know-how outside the Republic of South Africa;
- on the security of infrastructure, including processes, systems, facilities, technologies, networks, assets and services essential to the health, safety, security or economic well-being of citizens and the effective functioning of government;
- on the supply of critical goods or services to citizens or the supply of goods or services to government;

- to enable foreign surveillance or espionage or hinder current or future intelligence or law enforcement operations;
- on the Republic's international interests, including foreign relationships;
- to enable or facilitate the activities of illicit actors, such as terrorists, terrorist organisations or organised crime; and
- on the economic and social stability of the Republic.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

There are currently no complete prohibitions against FDI in relation to any particular sector.

ii Restricted sectors

South Africa does regulate foreign investment in, and ownership and control of, its strategic industries through sectoral regulation, including within the banking, insurance, and broadcasting and telecommunications sectors. The foreign investment restrictions in respect of each of these sectors are briefly discussed below.

Banking sector

The Banks Act of 1990 (the Banks Act) permits a foreign bank to apply to the Prudential Authority (operating within the administration of the South African Reserve Bank) for consent for the establishment of a representative office or a local branch of that foreign bank in South Africa. The Prudential Authority may grant the application, either unconditionally or subject to such conditions as the Prudential Authority may determine. A representative office has authority to promote and assist the business of a foreign bank, whereas a branch is authorised by the Prudential Authority to conduct the business of a bank. Consent to operate a branch of a foreign bank is subject to, inter alia, the relevant foreign bank fulfilling capital adequacy, risk management and other operational requirements. The Prudential Authority will not grant an application for the establishment of a branch office unless it is satisfied that the responsible supervisory authority of the foreign bank's country of domicile will exercise proper supervision over the foreign bank. The Banks Act provides that no person, other than the controlling entity of the bank (whether a local or a foreign entity), may acquire more than 15 per cent of the total nominal value or the total voting rights in respect of the issued shares of a bank without the prior approval of the Prudential Authority or the Minister of Finance, depending on the number of shares or voting rights that are to be acquired.

Insurance sector

The Insurance Act of 2017 prohibits persons from conducting insurance business in South Africa without being appropriately licensed by the Prudential Authority under that Act. The provision of reinsurance services directly or through agents or intermediaries in South Africa is considered to be the conduct of insurance business in the country. However, in instances where a South Africa-based customer secures insurance with a foreign insurer or reinsurer, the actions of the foreign insurer or reinsurer would not qualify as conducting insurance business in South Africa. The Insurance Act permits a foreign reinsurer to conduct insurance business in South Africa, subject to that foreign reinsurer being granted a licence and establishing both a trust (for the purposes of holding the prescribed security) and a representative office in South Africa. The requirements for a Lloyd's underwriter conducting insurance business in South Africa are similar to those applicable to a foreign reinsurer, except that a Lloyd's underwriter is not required to establish a representative office in South Africa. In addition, to qualify for a licence as a branch of a foreign reinsurer or a Lloyd's underwriter, an applicant's proposed licensing must not be contrary to the interests of prospective policyholders or the public interest.

Broadcasting and telecommunications sector

The Electronic Communications Act of 2005 (ECA) imposes limitations on foreign control of commercial broadcasting services. The ECA provides that a foreign investor may not, directly or indirectly, (1) exercise control over a commercial broadcasting licensee or (2) have a financial interest, or an interest in voting shares or paid-up capital in a commercial broadcasting licensee, exceeding 20 per cent. The ECA further caps the percentage of foreigners serving as directors of a commercial broadcasting licensee at 20 per cent. In terms of the regulations and notices issued under the ECA, the Independent Communications Authority of South Africa (the electronic communications regulator) will not approve the transfer of an individual licence where the transferee's ownership and control by historically disadvantaged persons is less than 30 per cent. However, the final regulations in respect of the Limitations of Control and Equity Ownership by Historically Disadvantaged Groups and the Application of the ICT, published on 31 March 2021 (the Equity Regulations), now require that in addition to compliance with the 30 per cent ownership requirement in respect of historically disadvantaged people, each holder of an individual licence must also comply with a 30 per cent ownership requirement in favour of black people (as defined in the B-BBEE Act). The Equity Regulations provide that compliance with the black ownership requirement will also constitute compliance with the equity requirements in respect of historically disadvantaged persons. The 30 per cent ownership requirement in respect of black people is not yet operative and will become effective on a date to be determined by the Independent Communications Authority of South Africa.

The ECA further regulates cryptography. Under the terms of the ECA, a foreign cryptographer must be registered with the Department of Communications as such prior to rendering cryptography services and supplying cryptography products in (or to persons in) South Africa. This registration obligation applies to foreign cryptography providers rendering their services or selling their products in South Africa, irrespective of whether they have a physical presence in the country.

Additional information

There are restrictions on foreign investors rendering business services (such as legal and investment brokerage services) without due authorisation. There are no explicit prohibitions against foreign state-owned enterprises making foreign investments in South Africa. However, transactions of this kind could be blocked under the Competition Act or public interest considerations embedded in various pieces of legislation, some of which has been discussed above.

V TYPICAL TRANSACTIONAL STRUCTURES

Foreign investors who seek to establish a physical presence in South Africa for the purpose of setting up new facilities or engaging in merger and acquisition activity typically establish a company to serve as a subsidiary. There are no restrictions on foreign investors incorporating a company as a subsidiary (or otherwise) in South Africa under the Companies Act of 2008 (the Companies Act). Most foreign investors incorporate a private company, which must have at least one director and one shareholder. The directors of a private company need not be South African. However, a private company may not have more than 50 members (shareholders). Should the foreign investor require an entity that may have more than 50 members, a public company may be its optimal corporate vehicle. Public companies are generally used where the founders anticipate offering securities to the public through initial public offerings, for instance. Both private and public companies attract limited liability, meaning that a shareholder's liability is restricted to its investment in the company. These companies are categorised as profit companies; other profit companies include personal liability companies, which are used by professional services providers, such as law firms. The Companies Act also makes provision for non-profit companies, which are obliged to apply their income and assets exclusively towards the promotion of the company's main objects.

The Companies Act also permits foreign investors to set up an external or domesticated company. An external company is a foreign company conducting business activities in South Africa through a branch office (referenced in the discussion of foreign banks in Section IV, above). The Companies Act requires that external companies submit their annual returns to the Companies and Intellectual Property Commission Office.

The Companies Act also provides for the domestication of foreign companies. A foreign company may make an application for the transfer of its registration in a foreign jurisdiction to South Africa and, upon approval of that application, the foreign company will 'exist' as a company in terms of the Companies Act (as if it had originally been incorporated and registered as such). Except as set out in the discussion in Section IV, above, there are no requirements for the shareholders or directors of any of these companies to be South African. When a foreign investor incorporates a local subsidiary, that subsidiary is treated as a local company for all intents and purposes. South African exchange control regulations apply to that subsidiary, including (without limitation) the requirement that the local subsidiary's transfer of intellectual property to an offshore affiliate be licensed to the affiliate and made subject to a taxable royalty payable to the local subsidiary.

When foreign investors enter into joint ventures with South African or foreign investors to pursue investment opportunities in South Africa, the joint ventures are treated as partnerships under South African law. If a partnership is unincorporated (i.e., not folded into a company), each partner attracts unlimited liability for the debt and other obligations of the partnership and of each other partner. If a partnership is incorporated into a limited liability company, the Companies Act applies to that partnership and the liabilities of the shareholders are limited to their respective investments in the company. Under South Africa law, although permissible, trusts are seldom used as vehicles for the operation of businesses.

Except for the national security interest considerations under the Competition Act (discussed above), there are no rules under South African law pertaining to takeover bids by foreign companies.

When a foreign investor's transaction in South Africa is limited to the purchase of movable property, that investor's obligations are limited to settling tax and import duty liabilities accruing to that purchase. Although there are no restrictions on a foreign investor's acquisition of immovable property (such as land and buildings), the purchase of immovable property by a non-resident foreign investor must be undertaken through a locally established company, in respect of which the foreign investor must appoint a South African resident public officer.

Although a discussion on taxes relating to specific transactions falls outside the scope of this review, we point out that if the foreign investor subsequently sells the shares in this company at a time when 80 per cent or more of the market value of those shares is attributable directly or indirectly to the immovable property, the sale will attract capital gains tax liability for the investor. The foreign investor may, however, get relief from double taxation under an applicable double taxation agreement.

As part of its efforts to attract FDI into the country, the South African government has established the special economic zone (SEZ) programme under the Special Economic Zones Act of 2014. This programme seeks to promote regional industrial development by providing incentives for foreign (and local) investors that elect to operate within the country's eight SEZs. These incentives include a reduced rate of corporate income tax, building allowances, a customs controlled area and tax relief, including tax incentives designed to support both greenfield (i.e., new industrial projects) and brownfield investments (i.e., expansions or upgrades of existing industrial projects).

When a foreign investor purchases securities, the foreign investor is obliged to notify an authorised dealer (generally commercial banks) of the purchase and have the securities endorsed 'non-resident'. This allows the foreign investor to repatriate dividends and other distributions paid in respect of those securities, as well as the capital realised from the ultimate sale of the securities. Authorised dealers are obliged to assess documentary evidence from the investor to ensure that the securities purchase transaction concluded with the foreign investor is at arm's length, at fair market-related prices and financed in an approved manner. The financing must be in the form of the introduction of foreign currency or rand from a non-resident rand account.

VI OTHER STRATEGIC CONSIDERATIONS

The South Africa government has resolved not to enter into any new bilateral investment treaties (BITs). Furthermore, the country will not renew any BITs that come up for renewal. Instead, the Investment Act will serve as a uniform position for investor protection and a substitute for all the country's BITs. The Investment Act provides for foreign investors and their respective investments to be treated no less favourably than South African investors in like circumstances. The expression 'like circumstances' is defined as meaning the requirement for an overall examination of the merits of the case by taking into account all the terms of a foreign investment, including a host of factors specific to South Africa and not the investor. Factors cited include:

- the effect of the foreign investment on the Republic and the cumulative effects of all investments;
- the sector that the foreign investments are in;
- the effect on third persons and the local community;
- the effect on employment; and
- the direct and indirect effects on the environment.

The Investment Act further provides for qualified physical security and legal protections for the foreign investor. Foreign investors and their respective investments will receive a level of physical security 'as may be generally provided to domestic investors in accordance with minimum standards of customary international law, subject to available resources and capacity'. The investors will also receive legal protection of investments in accordance with the right to property in terms of the South African Constitution. The Constitution qualifies the right to property by permitting expropriation for a public purpose or in the public interest, subject to compensation, the amount of which, and the time and manner of payment of which, have either been agreed by those affected or decided or approved by a court. The Investment Act empowers foreign investors to repatriate funds, subject to complying with taxation and other applicable laws.

The Act clarifies that the South African government, or any organ of state, may take the following measures, inter alia:

- to redress historical, social and economic inequalities and injustices, presumably through the promotion of B-BBEE;
- to promote and preserve cultural heritage and practices, indigenous knowledge and biological resources related thereto, or national heritage;
- to foster economic development, industrialisation and beneficiation; and
- to protect the environment and the conservation and sustainable use of natural resources.

These measures could potentially have the effect of unilaterally eroding foreign investors' rights under the Investment Act.

With regard to investment disputes, the Investment Act provides that the foreign investor may request that the Department of Trade, Industry and Competition facilitate mediation within six months of the investor becoming aware of the dispute. The Department of Trade, Industry and Competition has issued regulations spelling out the rules of mediation. Furthermore, the Investment Act provides that the government may consent to international arbitration in respect of the relevant investment, but only subject to the exhaustion of domestic remedies (these being either local arbitration or courts).

South Africa adopted the International Arbitration Act of 2017, thereby incorporating the United Nations Commission on International Trade Law's Model Law on International Commercial Arbitration (as amended in 2006) into South African law. This Act may apply only to foreign investors' disputes with non-governmental South African entities. As indicated above, the Investment Act applies to foreign investors' investment-related disputes with the South African government, both in the local courts and in arbitration proceedings. South Africa has yet to accede to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention) and, having regard to the dispute resolution provisions of the Investment Act, the South African government is unlikely to accede to the ICSID Convention in the near future.

Foreign investors planning to enter the market will be well placed if they understand the public interest considerations that the South African government is advancing in the industries or sectors in which they propose investing, particularly if their proposed market entry will be pursuant to a state-issued licence, public-private partnership or other form of state procurement. As noted above, the promotion of B-BBEE initiatives generally features prominently as a criterion for the award of licences and state procurement. Accordingly, a foreign investor may be required to enter into agreements with historically disadvantaged persons relating to, inter alia, ownership and management of its bid entity, and could possibly be required to consider the adoption of additional B-BBEE measures in its proposal to shore up its chances of success. In the minerals sector, for instance, a new mining right holder is obliged to have a minimum B-BBEE shareholding of 30 per cent.

VII OUTLOOK

The South African government is aware that the policy and regulatory frameworks applicable to various strategic sectors may be complex and cumbersome for foreign investors and has acknowledged this in its latest country investment strategy published in the Government Gazette. There are some interventions by government institutions to streamline and simplify policy and regulation in order to make the investment case for South Africa more appealing, but these are yet to yield significant results.

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Endnotes

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2 Approximately US$294,000 as at 30 December 2022.

Chapter 21

Spain

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Summary

I OVERVIEW

Spain has traditionally been a country that is open to foreign direct investment (FDI) and, as such, has a favourable legal framework for foreign investors. In fact, prior to the covid-19 pandemic, the basic applicable legislation[2] declared the general liberalisation of FDI in Spain, without making distinctions between residents of the European Union and non-EU residents. There were very limited exceptions to this liberalised regime, mainly in respect of activities concerning national defence and certain sectoral regulations.

Consequently, during the past decades, Spain has received significant FDI in key sectors, such as automotive, telecommunications, infrastructure, chemical, pharmaceutical and real estate.

However, in March 2020, the covid-19 pandemic had a significant effect on the Spanish economy, jeopardising the financial soundness of companies across the board. This motivated an urgent revision of the approach to FDI in Spain, ultimately seeking to control (and limit, if required) the acquisition of strategic companies by opportunistic foreign investors.

Against this backdrop, throughout the covid-19 pandemic, the government approved a set of urgent measures aimed at controlling FDI in Spain. These measures implemented (and subsequently refined) an *ex ante* screening mechanism for certain investments (the FDI screening mechanism), which include, temporarily, those made by investors in Member States of the European Union and the European Free Trade Association (EU/EFTA) (the temporary regime) concerning strategic sectors of the economy. In practice, the government gained broader authority to review and take remedial action on the grounds of public order, public security and public health with respect to certain FDI in Spanish companies and businesses.

This urgent reaction by the government was fully aligned with Regulation (EU) 2019/452 of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union (the EU FDI Regulation) and is the approach adopted by the European Commission to tackle the effects of the crisis in distressed companies. In March 2020, the European Commission openly encouraged:

> *Member States that currently do not have a screening mechanism, or whose screening mechanisms do not cover all relevant transactions, to set up a full-fledged screening mechanism and in the meantime to use all other available options to address cases where the acquisition or control of a particular business, infrastructure or technology would create a risk to security or public order in the EU, including a risk to critical health infrastructures and supply of critical inputs.*[3]

The increased scrutiny in Spain was not intended to be temporary and was not repealed at the end of the covid-19 pandemic. In fact, on 4 July 2023, the Government adopted a permanent implementing regulation to develop and refine the aforesaid FDI Regime. Nevertheless, given the political nature of these rules, the ultimate scope of FDI rules in Spain will largely depend on the outcome of the general elections that will take place in Spain in late July 2023, even though a permanent regime (more or less ambitious) can be expected regardless of the government in office.

In any event, the new policies should not be regarded as a barrier to FDI in Spain. As explained below, not all FDI is captured by the FDI screening mechanism, and that which is captured is cleared unconditionally in most instances. In practice, from an investor's perspective, the current regime should be regarded in most situations as any other regulatory filing, rather than an actual barrier to investing in Spain. In fact, the recent implementing regulation foresees a number of situations that are exempted from prior FDI approval.

II YEAR IN REVIEW

Since March 2020, the approach to FDI has shifted from the general principle of liberalisation of investments to a more restrictive approach, by which certain transactions require prior approval, ultimately seeking to protect key strategic sectors of the Spanish economy. Indeed, compared with 2021, formal requests for approval under the FDI screening mechanism have increased by 27 per cent in 2022.

The main developments during the past year include the recent adoption of an implementing regulation to develop and refine the existing regime, as well as an extension of the temporary regime applicable to EU/EFTA residents (for the third time since its implementation) until 31 December 2024.

Although the *ex ante* screening mechanism has resulted in an increased level of red tape for investors compared with the previous system, public sources indicate that most of the transactions reviewed during 2022 were cleared unconditionally.[4] In fact, during 2022, out of 98 formal requests for approval, only 73 transactions ultimately required prior authorisation. Of these, 63 were unconditionally cleared, nine transactions were cleared subject to remedies (i.e., 12.3 per cent) and only one was prohibited as it was not possible to impose any suitable remedies to clear the concerns identified. The remaining requests for approval were dismissed after it was determined that they were outside the scope of review.

Key investments cleared under the FDI screening mechanism from June 2022 to June 2023 include the following:

- Vivendi's acquisition of a stake of between 10.9 per cent and 15 per cent in the Spanish media conglomerate PRISA in May 2023. According to the official press release published by PRISA, the Spanish government authorised Vivendi to increase its initial shareholding in PRISA through the conversion of all PRISA's convertible subordinated notes held by Vivendi. A more ambitious proposed acquisition of up to 29.9 per cent of PRISA's share capital had been previously prohibited by the Spanish government in April 2022, marking the first prohibition under the FDI screening mechanism approved in 2020.
- Bain Capital's acquisition of ITP Aero in August 2022. The transaction concerned the acquisition of a major player in the aeronautics sector in Spain. According to the press release published by ITP Aero, clearance was subject to a number of conditions, including 'guarantees of national and European interest programmes with regard to location, maintenance of employment and headquarters', 'the proper handling of sensitive information' and reserving up to 27.5 per cent of ITP Aero's share capital for a consortium of Spanish industrial companies and institutions.
- China Three Gorges Spain's acquisition of certain photovoltaic assets (619MW) in Spain from Nexwell Group in February 2023. The investor was the Spanish subsidiary of the Chinese state utilities company, and while this was not the first investment in Spain in the renewable energy sector, it was the largest to date, increasing its current portfolio in Spain to more than 1GW. Despite its relevance and the nature of the investor, there is no public reference to remedies having been required to complete the transaction.

In practice, the application of the FDI screening mechanism has spanned a multitude of industries, the main ones by number of analysed transactions being (1) information and communications; (2) professional, scientific and technical activities; (3) manufacturing; (4) financial and insurance activities; (5) supply of electrical energy, gas and air conditioning; (6) retail and wholesale; (7) construction; (8) administrative activities and ancillary services; (9) transport and warehousing; and (10) healthcare activities. Nonetheless, given the lack of public decisions, there is no visibility on the details of the different investments that could provide a relevant precedent on the practice of the Authority other than those transactions that have been leaked to the press.

In this climate, due to the increasing sophistication of the rules, foreign companies that envisage transactions involving Spain should seek FDI advice at an early stage of planning the proposed investment, especially in strategic sectors that have already been subject to scrutiny and that will presumably continue to attract the attention of authorities going forward.

III FOREIGN INVESTMENT REGIME

i Policy

The main concern regarding FDI and the driver of the FDI screening mechanism, according to which the liberalisation regime is suspended for certain transactions, is the protection of public order, public safety and public health.

In this regard, prior to the current FDI screening mechanism, Article 7 of Law 19/2003 on the legal regime of capital movements and economic transactions abroad (Law 19/2003) already foresaw suspension of the liberalisation regime by the government where the transaction or legal act:

> *affects or may affect activities which, by their nature, form or conditions, affect or may affect activities related, even if only occasionally, to the exercise of public power, or activities directly related to national defence, or activities that affect or may affect public order, public safety and public health.*

In practice, there is a high level of discretion regarding the review of any given transaction. The definition provided by the relevant legislation is very broad and the meaning of 'public order, public safety and public health' is not expressly defined.

This discretion is also present at the time of determining whether a transaction is captured by the regime in the first place. As explained below, the scope of the FDI screening mechanism is broadly defined, despite the legislative effort to provide further guidance on the definition of the different criteria triggering a filing requirement and other relevant aspects of the applicable rules. Although the regime tends to mirror the EU FDI Regulation, and the new implementing regulation is a major development, a number of relevant practical questions remain open.

Experience shows that these rules are ultimately enforced following a combination of technical and political criteria.

ii Laws and regulations

The legislation concerning FDI in Spain, as of 1 September 2023, consists of the following:

- Law 19/2003;
- Regulation 571/2023, of 4 July, on Foreign Investments (the Implementing Regulation) repealing Royal Decree 664/1999, of 23 April, on Foreign Investments; and
- Ministerial Order of 28 May 2001, which regulates the procedures for authorisation and for declaring the investment (the Ministerial Order). According to the Implementing Regulation, this will continue to be in force on a temporary basis until a new implementing order is approved.

As explained above, a number of royal decree-laws were issued as a result of the covid-19 pandemic to implement (and refine) the current FDI screening mechanism, now consolidated in Law 19/2003, with the exception of the royal decree-laws implementing (and extending the validity of) the temporary regime for EU/EFTA investors, namely:

- Royal Decree-Law 34/2020, of 17 November, adopting urgent measures to support business solvency and the energy sector and on tax matters;
- Royal Decree-Law 12/2021, of 24 June, adopting urgent measures in the field of energy, taxation and energy generation and on the management of the regulation fee and water tariffs;
- Royal Decree-Law 27/2021, of 23 November, extending certain economic measures to support recovery; and
- Royal Decree-Law 20/2022, of 27 December, on measures to respond to the economic and social consequences of the war in Ukraine and to support the reconstruction of the island of La Palma and other situations of vulnerability.

The relevant authority to review reportable transactions, according to Article 14.6 of the Implementing Regulation, is the Directorate General for International Trade and Investment, which is part of the Ministry of Industry, Trade and Tourism. Scrutiny is carried out by the aforesaid Directorate, together with the Foreign Investment Board at a later stage of the process. However, the final decision rests with the Council of Ministers (together with the latter, the Authority), which approves – conditionally or unconditionally – or blocks the transaction following prior report from the Foreign Investment Board. Exceptionally, in those cases where the value of the investment is below €5 million, the decision is issued by the head of the Directorate General for International Trade and Investment.

iii Scope

FDI screening mechanism (for non-EU/EFTA investors)

FDI in Spanish companies (whether listed or unlisted) that is carried out either directly or indirectly (through the acquisition of a foreign entity owning a Spanish subsidiary) triggers a mandatory and suspensory filing requirement, provided that the following cumulative criteria are fulfilled:

- the investment is made by a foreign investor. Pursuant to Article 7 *bis* (1) of Law 19/2003, foreign investors are deemed to be (1) non-EU/EFTA residents and (2) EU/EFTA residents beneficially owned by non-EU/EFTA residents. This occurs when non-EU/EFTA residents ultimately possess or control, individually or jointly, directly or indirectly, more than 25 per cent of the share capital or voting rights of the investor, or otherwise exercise control,[5] directly or indirectly, over the investor;
- the investment qualifies as FDI. Pursuant to Article 7 *bis* (1) of Law 19/2003, these are (1) investments that result in the foreign investor holding a stake that is at least 10 per cent of the share capital of a Spanish company or (2) when, as a result of the corporate transaction, legal act or business, the investor acquires control[6] of a Spanish company or part of it (meaning, in practice, that the acquisition of assets, branches or businesses is also captured by the regime); and
- the investment fulfils either the objective or subjective criteria: from an objective point of view, because the target is active in a 'strategic sector' in Spain, as defined in Article 7 *bis* (2) of Law 19/2003 or, from a subjective point of view, because the investor meets certain features as defined in Article 7 *bis* (3) of Law 19/2003.

From an objective point of view, investments in the following sectors trigger a filing:

- critical infrastructures, whether physical or virtual (including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructures, and sensitive facilities), as well as land and real estate that is key to the use of such infrastructures, as such infrastructures are referred to in Law 8/2011 of 28 April, establishing measures for the protection of critical infrastructures;
- critical technologies and dual-use items, key technologies for industrial leadership and training, and technologies developed under programmes and projects of particular interest for Spain, including telecommunications, artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear, as well as nanotechnologies, biotechnologies, advanced materials and advanced manufacturing systems;
- supply of critical inputs, in particular energy, as referred to in Law 24/2013, of 26 December, in the electricity sector, and Law 34/1998, of 7 October, in the hydrocarbons sector, or those relating to strategic connectivity services, as well as raw materials and resources relating to food safety;
- sectors with access to sensitive information, in particular personal data, or with the capacity to control such information, in accordance with Organic Law 3/2018, of 5 December, on the protection of personal data and the guarantee of digital rights; and
- communication media, without prejudice to the fact that audiovisual communication services under the terms defined in Law 7/2010, of 31 March, General Law on Audiovisual Communication (currently Law 13/2022, of 7 July, General Law on Audiovisual Communication), shall be governed by the provisions of this Law.

The Implementing Regulation now provides guidance on how to interpret these sectors. This will allow the investor to carry out a more informed self-assessment to determine whether a filing is triggered, ultimately reducing the need to engage in consultations with the Authority. Nevertheless, the regime still remains broadly defined and it will continue to be difficult to exclude with certainty certain activities in 'grey areas'.

According to Article 7 *bis* (4) of Law 19/2003, the government may designate additional strategic sectors that may affect public security, public order or public health.

From a subjective point of view, and irrespective of the target's activities, a filing is triggered if:

- the foreign investor is directly or indirectly controlled by a foreign government, including any state bodies (e.g., state-owned enterprises and sovereign wealth funds);[7]
- the foreign investor has already made investments affecting public security, public order or public health in another EU Member State, and particularly in 'strategic sectors' (as defined above);[8] or
- there is a serious risk that the foreign investor engages in illegal or criminal activities affecting public security, public order or public health in Spain.[9]

Thus, if all the aforesaid thresholds are met, the investment will be captured by the FDI screening mechanism. This means that the transaction will be subject to a mandatory obligation to obtain clearance by the Council of Ministers (or the Directorate, as the case may be) prior to closing of the transaction; that is, there is a suspension obligation. As is further explained below, breaching this obligation is subject to sanctions.

Further, the Implementing Regulation now specifies that when two or more transactions between the same seller and buyer take place within a period of two years, these will be considered as a single transaction taking place on the date of the latest investment. This means that the aforesaid analysis shall be conducted for this single transaction and a filing may be triggered.

Temporary regime (for EU/EFTA investors)

Screening also applies temporarily (from 19 November 2020 to 31 December 2024) to FDI by residents of EU/EFTA countries. This temporary regime applies to direct or indirect investments in Spanish companies provided that all the following criteria are fulfilled (i.e., cumulative criteria):

- the investment is carried out by an EU/EFTA investor (i.e., (1) EU/EFTA residents and (2) Spanish residents beneficially owned by EU/EFTA residents). This occurs when EU/EFTA residents ultimately possess or control, directly or indirectly, more than 25 per cent of the share capital or voting rights of the investor, or otherwise exercise control, directly or indirectly, over the investor;
- the investment qualifies as FDI following the same indications explained above for the general regime (i.e., acquisition of a stake in excess of 10 per cent or control of a Spanish company);
- the investment fulfils the value threshold, which is met if the target is either:
  - a listed company in Spain; or
  - a private company and the investment is worth more than €500 million; and
- the investment fulfils the strategic sectors threshold, which is met if the target is active in a 'strategic sector' in Spain (i.e., those foreseen in Article 7 *bis* (2) of Law 19/2003, similar to those of the general regime).

If an investment made by an EU/EFTA investor satisfies the aforesaid thresholds, the transaction will be subject to a suspensory and mandatory filing requirement, and failure to do so will be subject to sanctions.

Exclusions and exemptions

The aforesaid regimes (both general and temporary) shall not apply if the target has no local subsidiary or other form of local presence in Spain (assets, branches and commercial offices, etc.). FDI screening is not applicable where the investment has null or negligible effects on public order, public health or public security in Spain. Further, the Implementing Regulation clarifies that neither internal restructurings nor transactions increasing the shareholding of an investor already exceeding the 10 per cent threshold (provided that no change in control takes place) are considered FDI in the sense of the regime and do not require approval.

Article 17 of the Implementing Regulation foresees a number of exemptions, namely:

- certain investments in the energy sector, regardless of the amount, provided that the investor does not meet any of the subjective criteria set out in Article 7 *bis* (3);

- a *de minimis* exemption for acquisitions of a Spanish target with turnover below €5 million in the past financial year, provided that the target does not have technologies developed under programmes benefiting from substantial public financing (Spanish or EU). However, such exemption is not applicable to acquisitions of (1) critical infrastructure, (2) certain electronic communications operators and (3) certain mineral raw materials;
- investments in real estate, provided that the property subject to investment is not attached to any critical infrastructure and is not indispensable and irreplaceable for the provision of essential services; and
- certain transitory investments of placers and underwriters dealing in securities (i.e., investments of a short duration (hours or days) where they do not have the ability to influence the management of the target company).

Sanctions for breaching the suspension obligation

An investment carried out in Spain without the required prior approval:

- renders the transaction invalid and without any legal effect in Spain until it has become compliant (i.e., in practice, the investor will not be able to exercise its governance and economic rights in the Spanish entity until the required approval has been obtained); and
- may carry a fine of between €30,000 and the transaction's financial value, plus public or private admonition (i.e., in practice, reputational damage and further scrutiny in future transactions).

iv Voluntary screening

The FDI screening mechanism is mandatory. Nevertheless, Article 9 of the Implementing Regulation foresees a formal consultation procedure. The statutory deadline is 30 business days, and the outcome of the consultation is binding for the Authority. The Authority may stop the clock to request additional information, and should the investor fail to provide such information, the consultation will be dismissed.

The Implementing Regulation implements a one-stop shop for consultations on whether the investment is also subject to the defence and arms, cartridges and explosive sectoral regimes, in addition to the general FDI screening mechanism. This tool will ultimately save time and provide increased certainty to investors.

The possibility of submitting a formal request for approval is suspended during the review of the consultation. Only if the result of the consultation is that formal approval is required, or in the absence of an express decision of the Authority following the statutory 30-business-day deadline, will the investor be able to formally request authorisation.

v Procedures

There is only one type of review procedure (the ordinary procedure) if a filing requirement is triggered (i.e., there is no fast-track procedure).

The party responsible for making a filing requirement is the investor. In the case of investments carried out by two or more investors in order to exercise joint control over the target, a single application for authorisation is required. Further, Article 10.2 of the Implementing Regulation clarifies that, if the investor is a collective investment institution, pension fund or alike, common in private equity deals, the party responsible for making a filing is the managing partner (e.g., the so-called general partner), provided that the partners or beneficiaries of the aforesaid investment institution (e.g., the so-called limited partners) do not exercise their governance rights and do not have privileged access to the company's information.

The investors shall request authorisation using an official questionnaire (the Questionnaire) provided by the Ministry of Industry, Trade and Tourism[10] and addressed to the Sub-directorate General for Foreign Investment.

It is also relevant to note the potential impact of the EU cooperation mechanism following the EU FDI Regulation, as well as the potential powers of the Authority to review a transaction that has not been notified.

Ordinary procedure

This may take up to three months (although formal requests for information from the Authority may stop the clock). Failure to obtain a decision after the legal deadline shall be understood as clearance not being granted.

The body in charge of the review is the Directorate General for International Trade and Investment of the Ministry of Industry, Trade and Tourism, through its Sub-directorate General for Foreign Investment. The latter carries out the review and issues a proposal that, after going through the Board of Foreign Investment (which issues a non-binding opinion), is ready for final review and decision by the Council of Ministers. The latter may clear – either unconditionally or subject to remedies (which may be either imposed by the Authority or offered by the investor prior acceptance of the Authority) – or block the transaction. The Authority may also shelve the file if the investor withdraws the application or because it deems that the investment is not subject to prior approval.

Article 11.1 of the Implementing Regulation requires the investor to notify the Authority of any changes to the authorised investment. When such modification substantially alters the conditions of the authorised investment, this will be subject to a new approval. In case of doubt, the investor may file a consultation to determine whether the altered conditions of the investment merit a new authorisation.

The Implementing Regulation foresees that when assessing the request for approval, the Authority shall take into account (1) the information provided by the investor; (2) the information provided by the European Commission or other Member States, or both, in the context of the EU cooperation mechanism; (3) the information provided by the Spanish Administration, as well as economic and social stakeholders; and (4) compliance by the country where the investor is resident with international commitments undertaken by Spain in areas concerning public security, health or public order.

The authorised investment must be carried out within the period specifically indicated in the authorisation or otherwise within six months. If this period elapses without the investment closing, the authorisation shall be deemed to have lapsed, unless an extension is granted. The investor may apply for a single extension for a period of six additional months. If the investment is not completed within the extended period, the investment shall be deemed not authorised.

The Council of Ministers' decision blocking or approving the investment subject to remedies may be either internally appealed (*recurso de reposición*) or directly appealed to the Supreme Court following the contentious administrative jurisdiction.[11] However, given the wide discretion and political nature of the Council of Ministers, it is reasonable to expect that any such appeals would be successful only on procedural grounds.

EU cooperation mechanism

With the EU FDI Regulation in place, several cooperation mechanisms need to be considered, including (if the potential transaction may affect public safety or public order in another Member State or at EU level) a consultation process with the European Commission and other Member States. This process may take between 15 and 40 calendar days and may affect the timing for clearance.

Furthermore, the Questionnaire contains a section intended to disclose certain information about the investment and its impact on other EU Member States. This information is actively shared among the different EU FDI authorities. In fact, the Authority analysed around 400 different transactions shared by other Member States through the cooperation mechanism in 2021 and 2022.[12]

Powers of the Authority to review unreported transactions

Article 12 of Law 19/2003 foresees that the Authority has powers to review and investigate unreported transactions that should otherwise have been filed. If, following such an investigation, the Authority concludes that the transaction was closed without the required prior approval, it may impose sanctions, as explained in Section III.iii, above.

vi Prohibition and mitigation

The FDI screening mechanism and temporary regime grant the possibility of prohibiting transactions or requiring conditions on their approval (either directly imposed by the Authority or offered by the investor and accepted by the Authority). To our knowledge, only one transaction has been blocked to date (i.e., the proposed acquisition of 29.9 per cent of PRISA's share capital by Vivendi in 2022).

In terms of remedies, these may be required to clear the transaction on grounds of public order, public security or public health. Following the entry into force of the Implementing Regulation, remedies may be either imposed by the Authority or offered by the investor (subject to the Authority's approval). The remedies could take any form, in principle, and be adapted to the specific nature of each transaction. To date, according to statistics published by the Authority, there have been only a few isolated cases in which clearance was subject to remedies (one transaction in 2020 was subject to remedies, six in 2021 and nine in 2022).

There is very limited visibility on the remedial action of the Council of Ministers because there is no public database of its decisions, which generally are not published, and, in major precedents, the Council of Ministers publishes only a brief summary of any conditions imposed on an investor. In this regard, the proposed acquisition of the energy provider Naturgy was cleared in August 2021, subject to a package of conditions. Most recently, according to public sources, the acquisition of the Spanish delivery company Glovo by Delivery Hero was conditionally authorised on 31 May 2022.

According to the 2022 annual report, there is no exhaustive list of mitigation measures, as it is complex to catalogue a set of remedies to address a range of risks of very diverse natures. In practice, the design of these remedy measures depends on the specific characteristics of each transaction and the threats identified. However, in general terms, the key mitigation measures adopted throughout 2022 were (1) measures aimed at ensuring the supply of certain goods or services considered essential and difficult to substitute for the provision of essential services, (2) measures to limit the access to sensitive information, (3) measures aimed at maintaining certain capacities and avoiding loss of sovereignty in certain areas, and (4) measures relating to the investor's obligation to provide information periodically or upon certain events.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

There are no prohibited sectors.

ii Restricted sectors

In addition to the screening mechanisms described above, certain acquisitions may require specific approvals or notifications from or to the relevant authorities in various sectors. Sectoral filing requirements are independent from any potential filing requirements under the FDI regimes – both could be required. The following are the key sectors to bear in mind when planning an investment concerning Spain (directly or indirectly).

- Banking sector (Law 10/2014 on the regulation, supervision and solvency of credit institutions): certain investments in a Spanish credit entity must be notified, prior to the investment, to the Bank of Spain.

- Insurance sector (Law 20/2015 on the regulation, supervision and solvency of insurance and reinsurance companies): certain investments in a Spanish insurer or reinsurer must be notified, prior to the investment, to the General Directorate for Insurance and Pension Funds.
- Energy sector (Law 3/2013 on the creation of the National Commission for the Markets and Competition): certain acquisitions in a company carrying out regulated activities in the energy sector shall be notified to the Ministry for Ecological Transition and Demographic Challenge within 15 days of closing the transaction. If the acquisition is made by a non-EU investor, conditions could eventually be imposed if the transaction poses a threat to Spain.
- Media sector (Law 13/2022 on General Audiovisual Communication): the acquisition of stakes in entities holding an audiovisual communication service licence in Spain by non-EU investors is subject to the principle of reciprocity, and the stake acquired by a non-EU investor may not exceed, directly or indirectly, 25 per cent of the share capital. Similarly, the aggregate stake of non-EU investors in the relevant entity must be less than 50 per cent of the share capital.
- Defence sector (Article 18 of the Implementing Regulation): any foreign direct or indirect investment (both EU and non-EU) in a Spanish company conducting activities directly relating to national defence requires authorisation by the Council of Ministers, except in cases where (1) the investment remains below 5 per cent of the share capital of the Spanish company, provided that the investor cannot, directly or indirectly, be part of the board of the company; and (2) if the stake acquired is between 5 and 10 per cent of the share capital of the Spanish company, provided that the investor notifies the transaction to the Ministry of Defence and attaches a notarised document where the investor undertakes not to use, exercise or assign its voting rights to third parties or take part in whichever managing bodies of the company.
- Activities directly relating to arms, cartridges, pyrotechnic artifacts and explosives for civilian use or other material for use by the State Security Forces (Article 19 of the Implementing Regulation): any foreign investments, whether direct or indirect, in Spanish companies with activities that involve the production, trading or distribution of arms, cartridges, pyrotechnic artifacts or explosives for civilian use require authorisation by the Council of Ministers.
- Public procurement and concessions: certain public contracts and public domain concessions may need authorisation for a direct or indirect change of control (or both) from the granting authority. This will typically depend on the tender specifications governing the contract.

V TYPICAL TRANSACTIONAL STRUCTURES

Foreign investors seeking to set up new facilities or businesses or to carry out mergers and acquisitions in Spain may potentially face scrutiny from Spanish authorities pursuant to the FDI screening mechanism, temporary regime or sectoral regimes, as explained above. Other than these, there are no relevant burdens for foreign investors.

i Corporate law residency requirements

Foreign companies and individuals with activities in Spain having a tax nature or with tax implications must have a tax identification number pursuant to Law 58/2003 on general taxation and Royal Decree 1065/2007 on the general regulations of the tax inspection and management procedures and developing the common rules of the procedures to apply taxes.

ii Takeover bids by foreign companies

Certain investments in listed companies in Spain may be subject to takeover rules (Royal Decree 1066/2007 on takeover bids). Generally, investors that acquire voting rights equal to or greater than 30 per cent in a listed company, or otherwise reaching the legal control threshold concerning the target's directors,[13] shall make a mandatory takeover bid for the entire share capital of the target. In practice, this means having to file an offer and a prospectus with the Spanish Securities Market Commission, which shall authorise the offer. These rules apply to both foreign and domestic investors.

iii Entering into joint ventures

Foreign companies entering into joint ventures in Spain with either national or foreign investors may still be subject to the FDI screening mechanism even if only a minority shareholding is being acquired. Greenfield joint ventures may also be captured by the regime. There are no specific limitations for foreign investors regarding joint ventures in Spain (e.g., no need for a domestic partner).

iv Typical corporate structures for conducting business operations

A foreign entity wishing to conduct operations in Spain may either incorporate a subsidiary (or acquire an existing company) or set up a branch. The subsidiary is an autonomous legal entity and may adopt any of the corporate structures foreseen in the Spanish legislation. In turn, a branch has no separate legal personality from the parent company to which it belongs. In practice, there are no major differences between the two options. There are no relevant burdens for foreign entities in this regard.

VI OTHER STRATEGIC CONSIDERATIONS

When considering a potential investment in a company in Spain or in a foreign company that has subsidiaries in Spain, the impact of the aforesaid FDI screening mechanism and temporary regime should be borne in mind, as this will help to effectively design the transaction from an FDI perspective and avoid further difficulties and delays at a later stage of the process. From a practical perspective, the following are some of the key aspects to consider.

i Timing

The legal deadline for clearance is three months from filing; therefore, it is essential to engage with the Authority early on, particularly if it is not clear whether the transaction triggers a filing requirement. This is also advisable in complex transactions because it will allow for better coordination and it may streamline the process overall. The Authority is typically keen to have an open discussion with the parties in complex transactions to address the relevant technicalities, tentative calendar and overall coordination of the process.

ii Contractual provisions

Closure of the transaction should be subject to obtaining the relevant FDI authorisation, if required. Furthermore, sufficient time should be allowed for the review period and it may be useful to include risk allocation provisions, particularly in the most challenging transactions that are cleared with conditions.

iii Activities of the target

A careful analysis of the activities of the target is advisable if the transaction is potentially problematic. This may help to design the perimeter of the transaction (e.g., by leaving out potentially problematic parts of the business that are not an essential driver of the deal and may be an obstacle for unconditional clearance).

iv Potential conditions

In complex transactions, it is essential to foresee potential conditions that may be imposed (not only in Spain but also in other jurisdictions). In fact, diverging outcomes could potentially be obtained when the transaction is notified in various jurisdictions. In this context, it is necessary to anticipate all plausible scenarios because the potential outcomes could jeopardise the deal economics and transaction rationale.

v Impact of other FDI filings

The different FDI authorities across the European Union actively share information about potential investments. Thus, it is key to adopt a consistent approach in transactions involving more than one EU Member State. Furthermore, reviews by other authorities may potentially affect the review of the transaction, particularly if they identify any substantive concerns. In terms of jurisdiction, if the transaction does not clearly meet the thresholds of the FDI screening mechanism but it will be reported in other Member States, this may have a relevant impact on the Authority taking jurisdiction.

vi Impact of other regulatory or competition filings

It can be reasonably expected that other filings could have an influence in the review of the transaction and even disclose transactions that have not been notified in Spain or abroad. In this regard, the Questionnaire expressly requests the investor to disclose whether the transaction is subject to any competition or regulatory filing requirements in Spain or in any other EU Member State. In fact, to the best of our knowledge, there is effective interaction between the Authority and other regulators. The Authority confirms in its 2022 annual report that in both 2021 and 2022 around 400 transactions were shared with Spain for its consideration on the basis of the cooperation mechanism.

vii Consortiums

It is common to carry out investment alongside other investors. Thus, it is relevant to consider the nature and background of the co-investor, as it may trigger a filing requirement in and of itself (irrespective of the target), and it may even increase the level of scrutiny. This is particularly important in auction bids, where the consortium may be at a disadvantage if other bidders do not trigger a filing requirement in Spain. It is advisable to seek expert advice to minimise such risks.

VII OUTLOOK

In terms of future trends, there are a number of items that foreign investors should bear in mind when planning a transaction in Spain. Please note that any potential developments regarding the FDI legislation are now on hold following the dissolution of the Spanish Parliament and are largely subject to the outcome of the general elections set to take place in late July 2023, as each of the political parties may adopt a different approach to FDI legislation:

- the temporary regime for EU/EFTA investors will remain in place until 31 December 2024. Further extensions cannot be excluded at this stage (note that the regime has already been extended three times), although this may largely depend on the outcome of the elections;
- the relevant legislative development may be partially or completely revisited if a new government is elected;
- the composition of the Authority may suffer changes also as a result of the general elections;
- many scenarios remain untested and there is uncertainty about how the Authority will apply in practice certain provisions of the new Implementing Regulation; and
- state-owned companies investing in Spain are increasingly subject to intense scrutiny, and even non-controlling investments are facing careful review by the Authority.

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2 Law 19/2003 on the legal regime of capital movements and economic transactions abroad and Royal Decree 664/1999 on foreign investment, which has been recently replaced by Royal Decree 571/2023 on foreign investment.

3 See, in this regard, C(2020) 1981 final – Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation).

4 See https://comercio.gob.es/InversionesExteriores/Documents/2022%20EN%20CIFRAS.pdf (last accessed 12 June 2023).

5 In this regard, 'control' shall be understood as defined in Article 7 of Law 15/2007 on Defence of Competition, which follows the concept of control for EU merger control purposes provided for in the Commission Consolidated Jurisdictional Notice.

6 See above regarding the concept of control.

7 For the purposes of determining whether an investor is controlled by a foreign government, the Implementing Regulation clarifies in Article 16.1(b) that investments made by vehicles through which funds of a public nature (or pension funds of public employees) are invested are not deemed to be under public control (and therefore exempted from prior FDI authorisation), if it is clear from the nature of the fund manager, the legal or statutory provisions for the appointment of its directors or other statutory provisions concerning its management or nature that its investment policy is independent and focused exclusively on the profitability of its portfolios without the possibility of political influence of a third-country government.

8 Article 16.2 of the Implementing Regulation makes express reference to the possibility of resorting to the cooperation mechanism foreseen by the EU FDI Regulation in order to ascertain whether the investor has made any such investments.

9 Article 16.3 of the Implementing Regulation explains that, in order to determine the existence of such risk, preference will be given to administrative or judicial sanctions imposed in the past three years, particularly in areas such as money laundering, environmental, taxation or the protection of sensitive information.

10 https://comercio.gob.es/InversionesExteriores/Documents/Formulario_28_03_2023.docx (last accessed 12 July 2023).

11 See Organic Law 6/1985, Article 58, on the Judicial Power.

12 See Annual Report 2022, p.6.

13 Where it has acquired, directly or indirectly, a lower percentage of voting rights and appoints, within 24 months of the acquisition date, a number of directors who, together with those already appointed, if any, represent more than half of the members of the board.

Chapter 22

Thailand

Wayu Suthisarnsuntorn[1]

Summary

I OVERVIEW

Although Thailand has relied heavily on foreign direct investment during the past few decades,[2] and despite the government's several attempts over the past few years to attract foreign direct investment into the country, it has never been an easy task for foreign individuals and corporations to legally operate in Thailand, as there are numerous Thai laws that either prohibit outright or to a certain extent restrict foreign parties from engaging in various businesses in Thailand, the most notable of which is the overarching Foreign Business Act 1999 (FBA).

The FBA generally prohibits and restricts foreigners from operating in more than 40 categories of businesses in Thailand unless they have successfully obtained a foreign business licence from the government, which is not easy to obtain in practice, or unless they are otherwise exempted from the restrictions under the FBA.[3]

The term 'foreigners' under the FBA is defined to include not only non-Thai individuals and legal entities established under the law of another country but also locally incorporated entities 50 per cent or more of whose total issued shares are owned by other foreigners.[4] These are commonly referred to as majority foreign-owned companies, although the term technically includes locally incorporated joint ventures owned equally by Thai and foreign shareholders. By definition, subsidiaries in Thailand of all foreign companies are considered foreigners under the FBA and hence are subject to the restrictions and requirements thereunder.

Therefore, foreign corporations seeking to expand their business operations into Thailand should thoroughly consider, among other Thai laws, the FBA and its implications before establishing a subsidiary in Thailand or acquiring a majority stake in any existing Thai business.

The FBA divides prohibited and restricted business activities into three different annexes titled List One, List Two and List Three, respectively. Generally speaking, foreigners may not engage in any business activity under List One.[5] Theoretically, foreigners may engage in business activities under List Two if they receive approval from the Council of Ministers (the Cabinet). However, as a matter of practice, for the past 20 years or so of the FBA, the Cabinet's approval has been unavailable. Finally, for foreigners to operate any business activity under List Three, an approval (in the form of a foreign business licence) is required from the Foreign Business Commission, a body of senior government officials headed by the Permanent Secretary of the Ministry of Commerce.[6]

There are several exemptions to the broad restrictions imposed on foreigners under the FBA, such as by:

- obtaining an approval from Thailand's Board of Investment (BOI) or the Industrial Estate Authority of Thailand (IEAT);[7]
- having the minimum required capitalisation for certain businesses;[8]
- applying for protection under certain treaties between Thailand and a handful of countries;[9] or
- being generally exempted through the issuance of ministerial regulations.[10]

However, these exemptions come with limitations. For example, the BOI grants an approval to applicants only for eligible businesses based on the BOI's investment promotion policies at that time, and a BOI approval covers only a particular project (usually a business line or process) of the applicant that is approved by the BOI. As such, if a foreigner has more than one project in Thailand and only one of them is approved by the BOI, the foreigner would still be subject to restrictions under the FBA with respect to its other activities that are not approved by the BOI. As another example, protection under the Treaty of Amity and Economic Relations Between the Kingdom of Thailand and the United States of America applies only to qualified American companies and nationals. Other foreigners may not seek protection (i.e., exemption from the FBA) under the aforesaid Treaty.

Even when a particular business of a foreigner is not prohibited or restricted under the FBA, a foreigner operating such a non-restricted business in Thailand is still subject to certain requirements under the FBA; for example, under the minimum capital requirement, foreigners must bring into Thailand within a certain period a minimum amount of capital in connection with their contemplated business operations.[11]

Apart from the FBA, there are many other industry-specific laws that also regulate foreign direct investment in Thailand in parallel, such as the Financial Institution Business Act 2008, the Insurance Act 1992, the Telecommunications Business Act 2001, the Broadcasting and Television Business Act 2008, the Land Transport Act 1979, the Air Navigation Act 1954, the Private Schools Act 2007, the Tourism Business and Guides Act 2008, the Job Placement and Job Seekers' Protection Act 1985, and the Agricultural Land Leases Act 1981. Some laws have their own unique (stricter) definition of foreigners that are subject to regulation. For example, the Agricultural Land Leases Act 1981 (as amended in 2016) defines foreigners as companies established under Thai law but 25 per cent or more of whose shares are owned by other foreigners, or 25 per cent or more of whose shareholders are foreigners.[12] Other laws limit foreign direct investment in companies that are qualified to obtain a certain business licence from the relevant regulator under those laws by using a different shareholding threshold and other tests. For example, to apply for a tourism business licence under the Tourism Business and Guides Act 2008, at least 51 per cent of the total issued shares in the applicant companies must be held directly by Thai nationals, at least 50 per cent of the board of directors of the applicant companies must be Thai nationals and authorised directors of the applicant companies must also be Thai nationals.[13]

In addition to the above, the Land Code (effective since 1954) generally prohibits foreigners from owning land in Thailand, with very limited exceptions. Generally speaking, foreigners may own only land plots located within authorised industrial estates[14] or land plots specially approved by the BOI for use in BOI-promoted investment projects.[15] The same foreign land ownership prohibition also applies to locally incorporated companies more than 49 per cent of whose shares are owned by foreigners, or more than 50 per cent of whose shareholders are foreigners.[16]

In light of the foregoing, a joint venture company that is partially owned by foreign shareholders may be considered or treated as a foreigner under one law but not under another law. For example, a locally incorporated company 50.01 per cent of whose total issued shares were owned by Thai nationals and the remaining 49.99 per cent owned by foreigners would be considered a Thai company (not a foreigner) under the FBA; nonetheless, that same company could not own any land in Thailand because it would still be treated as a foreigner under the Land Code.

To legally avoid being captured at all by the broad scope of application and complicated implications of the FBA and other Thai laws regulating foreign direct investment, many foreign companies decide to form joint ventures with Thai parties and let the Thai parties own a majority of the shares in the joint venture companies. Nevertheless, the foreign parties can, to a certain extent, retain control over such joint venture companies through contractual arrangements and other legal mechanisms.

Many foreigners, however, instead try to avoid the application of the FBA by using Thai nominees to hold shares in local companies on their behalf. This practice is illegal and both the Thais and the foreigners involved in arrangements of this kind could be subject to severe penalties under the FBA, including a maximum imprisonment term of three years or a fine of up to 1 million baht, or both.[17]

Finally, it should also be noted that foreign nationals working in Thailand (whether for foreign subsidiaries, majority Thai-owned companies or otherwise) are also required to obtain work permits from the Department of Employment of the Thai Ministry of Labour under the Thai work permit law.[18] The number of work permits that a company may obtain for its foreign employees depends on several factors, including its registered and paid-up capital. As a general rule, 2 million baht of capital is required for every work permit quota. Therefore, this factor also needs to be taken into account when considering establishing a subsidiary in Thailand, entering into a joint venture in Thailand or acquiring a majority stake in a Thai company, as it may affect the capital structure of the local company.

II YEAR IN REVIEW

The main problem with the FBA has always been the way it is interpreted by the Department of Business Development (DBD) of the Thai Ministry of Commerce, a government agency responsible for the overall compliance with and licensing and enforcement of the FBA. There are many controversies around interpretations of the law by the DBD, as many of them are counterintuitive or sometimes even unreasonable.

For example, pursuant to the DBD's current interpretation, the final item of restricted businesses under List Three – other service business – covers almost everything, including activities that would not generally be considered services in an ordinary sense, such as property rental, cash pooling arrangements between affiliated entities, issuance of a corporate guarantee in favour of an affiliated entity and original equipment manufacturer (OEM) manufacturing, etc. From time to time, and usually in response to formal written enquiries from private parties, the DBD publishes its opinions and interpretations of the FBA on its website in an attempt to clarify various issues and questions arising out of the FBA. These interpretations are colloquially referred to as DBD rulings.

DBD rulings are not in themselves laws. Thai courts (which have the ultimate authority to interpret the FBA and punish those who violate it) are not legally bound by these rulings and they may interpret the law differently. However, because no one has ever officially challenged them in Thai courts, most of the controversial interpretations of the FBA expressed by the DBD in its rulings stand to this day. In addition, as a matter of practice, in the absence of Thai court precedents on the subject matter, DBD rulings are generally observed by multinational corporations doing businesses in Thailand to avoid regulatory issues with the DBD, as well as potential business disruption, costly litigation and criminal liabilities that may accompany a non-compliance investigation by the DBD and other government agencies.

The following are selected rulings issued by the DBD from May 2021 to June 2023:

- Reimbursement of expenses from an affiliate: an offshore foreign company sent its employees to Thailand for a specific business reason. Certain hotel and travelling expenses of the employees were advanced by another foreign company registered in Thailand that was an affiliate of the offshore company sending its employees to Thailand. Pursuant to a June 2021 ruling, a local company may not seek reimbursement of expenses advanced from an offshore affiliated company (even at cost and without any profit) unless it has successfully obtained a foreign business licence from the Foreign Business Commission.
- Rooftop solar: the DBD issued a ruling in November 2021 confirming its position that a foreign business licence was required before a foreigner (a building owner) could legally allow another party to use the foreigner's building rooftop areas for installation and operation of solar panels.
- Resales of unused raw materials: a foreigner previously operated a battery assembling factory but subsequently changed its business to do other things. The foreigner's sales of unused raw materials it had previously acquired for assembling batteries required a foreign business licence pursuant to the DBD ruling issued in December 2021, as the DBD took the position that by selling such materials the foreigner would be engaged in a wholesale business. However, sales of waste and by-products from manufacturing processes are not considered a restricted business according to another ruling issued by the DBD in May 2022.
- Carbon credit trading: a foreigner participated in a greenhouse gas reduction programme to earn carbon credits and sell them to other parties. The aforesaid activities required a foreign business licence pursuant to a ruling issued by the DBD in February 2022. Similar rulings were issued in April 2022 and May 2022.
- Charging back transport costs without any markup: a foreigner operated a wholesale business in Thailand. If a customer of the foreigner required an urgent delivery of products, the foreigner would hire a third-party transporter to deliver the products and separately charge the customer an extra transport fee equal to the amount the foreigner paid to the transporter. The DBD issued a ruling in March 2022 stating that the foreigner in question was deemed to engage in a restricted transport service

although the foreigner itself did not actually handle the delivery or generate any profit from arranging the delivery. Similar rulings were issued in May 2022, August 2022, and October 2022.

- Lending of equipment as a sales promotion: a foreigner wholesaler of chemical products lent certain necessary equipment to its customers for use in conjunction with the foreigner's products without charging any fees for such lending. The DBD ruled in October 2022 that such lending did not constitute a restricted business under the FBA as it was a mere sales promotion method. However, in cases where the equipment was damaged by a customer and the foreign party charged the customer any damage or compensation, such practice would constitute provision of a repair service or retail of necessary spare parts required to repair the damaged equipment, which would require a foreign business licence.
- Provision of services outside of the designated business location: a foreign service provider received a foreign business licence to provide certain services at its business location. It asked the DBD whether or not the existing licence allowed it to provide the same services to its customers at the customers' locations. The DBD issued a ruling in November 2022 that the licence covered only provision of services at the designated location.

In addition to the above-mentioned rulings issued by the DBD in connection with the FBA, a few other government agencies responsible for other laws have also recently been noted for taking a more aggressive stance with respect to foreign companies doing business outside Thailand but targeting customers in Thailand, which is arguably beyond their jurisdiction.

For example, in July 2021, the Thai Securities and Exchange Commission (SEC) accused a major cryptocurrency trading platform based outside Thailand of illegally operating a crypto exchange 'in Thailand' without an approval from the SEC. In essence, the SEC argued that by creating a Thai language website intentionally targeting customers in Thailand the offshore trading platform is considered by the SEC as operating the exchange in Thailand, even though it may not have any local physical presence in the country.[19]

As another example, the National Broadcasting and Telecommunications Commission (NBTC) issued a public statement in February 2021 condemning a global satellite internet provider for its solicitation of customers specifically in Thailand using Thai language marketing materials. The NBTC argued that the company cannot legally provide internet services to customers in Thailand without first obtaining a proper internet service provider licence from the NBTC, despite the fact that the company does not have any physical presence in Thailand and the internet services are to be provided from satellites orbiting the globe.[20]

It is still unclear whether the SEC and the NBTC actually have legal jurisdiction over the offshore business operators in question, as there has not yet been any court precedent on the matters. Nevertheless, the outcomes of these cases may change the legal landscape of Thailand in the future.

III FOREIGN INVESTMENT REGIME

i Policy

Section 5 of the FBA sets out the main principles for allowing foreigners to operate restricted businesses in Thailand as follows:

> *In granting permission to foreigners for the operation of businesses under this Act, regard shall be had to advantageous and disadvantageous effects on national safety and security, economic and social development of the country, public order or good morals, national values in arts, culture, traditions and customs, natural resources conservation, energy, environmental preservation, consumer protection, sizes of undertakings, employment, technology transfer and research and development.*

Generally speaking, the government is rather reluctant to allow foreigners to operate restricted businesses in competition with Thai businesses (and the scope of restricted businesses is interpreted very expansively). Although it is stated in the 2022 annual report of the Foreign Business Commission that the Commission's goal is to create a balance between foreign investment promotion and Thai business protection,[21] in reality, protectionism still plays a very critical role in determining whether a foreign business licence would be granted to any particular applicant.

In practice, the Foreign Business Commission would issue a foreign business licence to an applicant only if the Commission believes that the overall Thai economy would somehow benefit from the proposed business of the applicant (for example, the applicant's business requires high investment in Thailand, uses advanced technologies with potential technology transfers or would create a large number of local employment opportunities) or the applicant's business has a very limited impact on other Thai businesses (for example, the applicant's business relates to inter-group company transactions).

ii Laws and regulations

The FBA is the main law that prohibits or restricts foreigners (a term that is defined to include foreign nationals, foreign legal entities and majority foreign-owned, locally incorporated entities) from operating a vast majority of businesses in Thailand, including farming, animal husbandry, fishery, domestic transportation, mining, construction, domestic trading of goods, agency and brokerage services, hospitality, tourism, restaurants and most other services.

The government agency directly responsible for the overall compliance, licensing and enforcement of the FBA is the DBD of the Ministry of Commerce.

The Department of Special Investigation (DSI) of the Ministry of Justice also has the authority to investigate potential violations of the FBA that are criminal offences. The DSI is generally responsible for investigating complex criminal matters or criminal matters that have or could have a severe impact on the general public. The DSI is usually involved in investigations into the purported use of illegal Thai nominees by foreigners to circumvent foreign direct investment regulation under the FBA and foreign land ownership restrictions under the Land Code. The DSI works closely with the DBD and the Land Department on such investigations.

A violation of the FBA, such as operating a restricted business without a foreign business licence or using a Thai nominee to own shares in a local company to circumvent restrictions, could result in the imposition of severe penalties against the offender, including a monetary fine of between 100,000 baht and 1 million baht or a maximum imprisonment term of three years, or both. In cases where the offender is a company, the company directors and executives, who have responsibility for the violation of the FBA by the company, are also subject to the same penalties. Furthermore, offenders would be ordered by a Thai court to cease business operations in Thailand that are in violation of the FBA; a failure to comply with such a court order would subject the offender to an additional fine of between 10,000 baht and 50,000 baht per day throughout the period of the violation.

iii Scope

Any transaction that results in a foreigner holding 50 per cent or more of the shares in a company in Thailand may subject the company to foreign direct investment regulation under the FBA.

However, depending on the circumstances, the threshold that could trigger the foreign direct investment regulation may be lower in certain sectors, such as agriculture and broadcasting, or if the local company owns land in Thailand.

Thai laws generally apply within the geographical territory of Thailand and do not have extraterritorial jurisdiction. However, a few government agencies, including the DBD, the SEC and the NBTC, have recently tried to apply Thai laws to business operators outside Thailand that actively solicit customers in Thailand. Nevertheless, there have not yet been any reported court cases confirming or denying the jurisdiction of government agencies in these scenarios.

iv Voluntary screening

It is possible for foreigners to seek clarification from the DBD and other government agencies about whether their proposed business in Thailand is subject to any foreign direct investment regulation under Thai laws. However, each government agency would respond to enquiries of this kind only from the limited perspective of the particular laws the agency is directly responsible for.

For example, a foreigner may ask the DBD to confirm whether its proposed business would be subject to regulation under the FBA. However, the DBD would not confirm whether the proposed business would be regulated by any other government agencies under any other sector-specific laws applicable to the business in question. In other words, a foreigner must by itself, or with assistance from its local counsel, identify any relevant agencies and separately approach each of these to obtain a complete answer encompassing all relevant government agencies.

Note also that government agencies are usually slow in responding to these enquiries. It is not unusual for enquirers, whether Thai or foreign, to have to wait at least a few months for any written response from the relevant agency and, in many cases, after a few months of waiting, the response received might not be useful, as they sometimes do not actually answer the question asked.

The language barrier is another factor that should also be considered. In Thailand, the only official language is Thai. All laws and regulations are only officially published in the Thai language. English translations are never considered official translations, even though they may be made available by relevant government agencies. Many laws and regulations do not even have an unofficial English translation available.

In light of the foregoing, it is a very common and prudent practice for foreign companies seeking to expand their business operations into Thailand to engage qualified local legal counsel to guide them through foreign direct investment regulation in Thailand and provide necessary assistance in dealing with government agencies to ensure full compliance with applicable Thai laws.

v Procedures

To apply for a foreign business licence, an application and all required supporting documents, including detailed descriptions of the proposed business, financial forecasts and technology transfer plans (if applicable), must be submitted to the Foreign Business Commission through the DBD. The DBD may accept or reject a foreign business licence application for several reasons, and also on the basis of its internal policies.

If an application is accepted by the DBD, it would be passed on to the Foreign Business Commission for its formal consideration. The Commission meets only once a month or less frequently, so applicants must wait until the Commission convenes a meeting. It is also possible that if there are many pending applications at a particular moment, some applications may be postponed for consideration at the following meeting.

The law states that the Commission has a time frame of 60 days from the date of receipt of an application to consider the application.[22] However, in reality, this may not always be the case.

If the application is approved by the Commission, the applicant would be required to pay a one-time licensing fee of between 20,000 baht and 250,000 baht depending on the registered capital of the applicant before a foreign business licence is officially granted. Foreign business licences are valid for an indefinite period until they are revoked by the Commission or voluntarily cancelled by the licence holders.[23]

Foreign business licences usually come with some conditions (as shall be determined by the Foreign Business Commission as it sees appropriate) including, at the minimum, the following standard licensing conditions:[24]

- the licence holder must maintain a minimum registered capital of a certain sum;

- the licence holder may not borrow more than seven times the amount of its capital; and
- the licence holder must appoint at least one individual residing in Thailand as the person legally responsible for the licensed business operations.

By contrast, if the application is rejected by the Commission, the applicant may, in theory, appeal against the Commission's decision to the Minister of Commerce within 30 days.[25]

In practical terms, the overall process of obtaining a foreign business licence usually takes around six months or more (including the time required for discussions between foreigners and their local counsel and the time required to prepare the application and gather all supporting documents and information).

Alternatively, if a foreigner is qualified for an exemption under the FBA with an approval from the BOI or the IEAT or qualified for protection under a certain treaty between Thailand and another country, the foreigner would instead need to apply for a foreign business certificate from the DBD.[26] The process of obtaining a foreign business certificate is much easier and quicker than obtaining a foreign business licence as it does not involve the exercise of any discretion by the DBD: that is, if all documents are complete and correct, the DBD must issue a foreign business certificate to the applicant. The legal time frame for the DBD to process a foreign business certificate application is 30 days.[27] There is a certificate issuance fee of 20,000 baht payable by the applicant. Foreign business certificates are valid for an indefinite period as long as the holder still maintains the underlying privilege on the basis of which the foreign business certificate is issued (i.e., the BOI's or the IEAT's approval or treaty protection, as applicable).

vi Prohibition and mitigation

It has been reported that 227 foreign business licence applications were submitted to the Foreign Business Commission for its consideration in 2022, and 218 of these applications (around 96 per cent of the submitted applications) were eventually approved.[28] In reality, however, it is likely that there were many other uncounted applications that did not even reach the Commission as they would have been rejected by the DBD, acting as gatekeeper for the Commission, sometimes on the basis of unwritten policies.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

All business activities included in List One of the FBA are absolutely prohibited for foreigners.[29] These include most basic agricultural activities such as:

- farming, plantation or crop growing;
- animal husbandry; and
- fishery, only in respect of the catching of aquatic animals in Thai waters and exclusive economic zones of Thailand.

Other prohibited sectors under List One of the FBA are as follows:

- newspaper business, operating a radio broadcasting station or operating a television broadcasting station;
- forestry and processing of timber from natural forests;
- extraction of Thai herbs;
- trading and auction sales of antique objects of Thailand or objects of historical value of the country;
- making or casting of Buddha images and monk alms bowls; and
- land trading.

In theory, foreigners may engage in business activities included in List Two of the FBA with approval from the Cabinet. However, in practice, such approval is not available as a matter of policy. Therefore, all activities listed in List Two are also effectively prohibited for foreigners.

Examples of business activities under List Two are as follows:

- domestic transport, whether by land, water or air;
- production, distribution and maintenance of firearms and military equipment;
- production of sugar from sugar cane;
- production of salt;
- mining; and
- timber processing for the production of furniture and utensils.

The full list of all prohibited business activities is available in an unofficial English translation of the FBA.[30]

ii Restricted sectors

List Three of the FBA includes 21 categories of restricted business activities, examples of which are as follows:

- fishery, only in respect of hatching and raising aquatic animals;
- production of plywood, veneer wood, chipboards or hardboards;
- accounting services;
- legal services;
- architectural services;
- engineering services;
- construction (with some exceptions);
- brokerage and agency services (with some exceptions);
- domestic trade of agricultural products or produce;
- retail of any goods (with an exception under the minimum capitalisation rules);
- wholesale of any goods (with an exception under the minimum capitalisation rules);
- advertising business;
- hotels, except for hotel management;
- sales of food and beverages; and
- other service businesses (except as prescribed in ministerial regulations).

Foreigners that wish to operate any of these businesses must obtain a foreign business licence from the Foreign Business Commission, which may or may not be eventually granted depending on the circumstances and ever-changing policies of the government.

The most problematic restricted business category is the catch-all item for 'other service businesses' under List Three (21). Over the years, this particular item has been interpreted by the DBD extremely expansively to cover many activities that may not, in an ordinary sense, be considered services. It even covers some administrative and ancillary services provided without charges between parties within the same group of companies, for example property rental, cash pooling arrangements, issuance of a corporate guarantee and OEM manufacturing. Most of the latest DBD rulings discussed in Section II are considered restricted activities by the DBD under this particular item.

Manufacturing is the only sector that is not heavily restricted under the FBA. However, this does not mean that foreigners may engage freely in any manufacturing business in Thailand, because manufacturing of some products is still restricted. For example, firearms, military equipment, goldware and silverware are restricted under List Two. Meanwhile, manufacturing of, inter alia, plywood and veneer wood is restricted under List Three. In addition, OEM manufacturing (i.e., manufacturing of goods based on customers' specifications or formulas) is considered a service and thus is restricted under List Three (21).

There are also other industry-specific laws that require business operators to obtain a licence from the relevant regulator and, to qualify for a licence application, the applicant company must meet a certain minimum Thai shareholding threshold (and sometimes have a minimum number of Thai individuals on the board of directors or other qualifications) as specified by those laws. For example, to obtain a commercial land transport licence under the Land Transport Act 1979, applicant companies must have at least 51 per cent of their shares held by Thai shareholders. In addition, at least 50 per cent of the members of the board of directors of the applicant companies must be Thai nationals.[31] As such, foreigners may be only minority shareholders in companies engaging in such businesses.

V TYPICAL TRANSACTIONAL STRUCTURES

The most common form of legal entity for operating businesses in Thailand is a private limited company under the Civil and Commercial Code (CCC). The CCC itself does not require any minimum capital or contain requirements on the nationality or residency of directors. The CCC requires only that private limited companies have a minimum of two shareholders, one director and a registered address in Thailand.

However, company legal structures could be affected by requirements under special laws that regulate foreign direct investment, including the FBA. For example, if a private limited company established under the CCC is considered a foreigner under the FBA and it wishes to obtain a foreign business licence, it would need to have, at the very least, minimum capital of 3 million baht and at least one director (of any nationality) resident in Thailand and legally responsible for the licensed business operations. Other industry-specific laws may impose additional requirements, such as a minimum number of Thai directors on the board of directors and requirements on the nationality of the authorised signatory directors.

To ensure that they will not be disqualified from obtaining and maintaining key licences required to operate their core businesses, some companies may have a maximum limit of foreign shareholding threshold written in their articles of association, corresponding to the threshold prescribed in the relevant law under which the key licences are obtained.

The general process of purchasing shares in Thai companies does not differ between Thai and foreign purchasers. However, foreigners interested in purchasing shares in a Thai company must be mindful of the consequences of the target company being then considered a foreigner under the FBA, the Land Code or other industry-specific laws as a result of the acquisition.

It is quite common for foreigners to form an incorporated joint venture with Thai parties by structuring a joint venture company in such a way that it is majority owned by the Thai parties so that the company is not considered a foreigner and hence is not subject to various restrictions under the FBA and other laws. It is generally possible for foreigners in these circumstances to maintain control over the joint venture company (to a certain degree) through various mechanisms, such as by inserting into a joint venture agreement veto rights or consent requirements in connection with important board and shareholder matters. The most important issue for foreigners always to keep in mind, however, is that the Thai shareholders in their joint venture company must be genuine shareholders who invest their own money and hold shares in the company for their own interest and benefits. They cannot be mere nominee shareholders of the foreign parties holding shares on the foreigners' behalf, because the use of Thai nominee shareholders to circumvent foreign direct investment regulation is illegal under the FBA and subject to severe penalties, including a maximum imprisonment term of three years or a fine of up to 1 million baht, or both. The aforesaid penalties are imposable on both the foreign parties and the Thai nominees.[32]

VI OTHER STRATEGIC CONSIDERATIONS

Merger control is new territory under Thai law as it started to be implemented only in late 2018 pursuant to the Trade Competition Act 2017 and regulations issued thereunder.

Mergers and acquisitions of businesses in Thailand that have a significant share in a particular market and, under the current regulations, a minimum turnover of 1 billion baht in the previous year may require a pre-merger approval from the Trade Competition Commission or a post-merger notification to the Commission, depending on the circumstances.[33]

There are no special rules applicable to foreign acquirers at present. However, the consequences of a target business becoming a foreigner under various Thai laws as a result of an acquisition should always be considered carefully.

VII OUTLOOK

The 2022 annual report of the Foreign Business Commission indicated that further relaxations on restricted services under the FBA are being considered.[34] These services include:

- aircraft maintenance;
- software business;
- digital content business;
- insurance brokerage;
- lending with securities as collateral;
- securities agency or consultancy;
- fund management;
- Thai herb extraction; and
- animal husbandry.

However, it is still unclear at this stage whether these relaxations will ultimately come into effect.

In contrast, it should be noted that there have been attempts by a few regulators, including the SEC, the NBTC and the DBD, to apply Thai laws to offshore companies operating outside Thailand but targeting or transacting with customers in Thailand (as discussed in Section II).

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Endnotes

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2 https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?end=2019&locations=TH&name_desc=true&start=1970&view=chart.
3 FBA, Section 8.
4 FBA, Section 4.
5 An unofficial English translation of the FBA, including the three annexes of prohibited and restricted business activities, can be found on the following website: https://www.dbd.go.th/dbdweb_en/download/pdf_law/FOREIGN_BUSINESS_ACT_BE2542/act/1FBA-FINAL[1].pdf. Note that only the official Thai version of the FBA has legal effect. The English translation is provided here just for the convenience of readers. We do not in any way confirm the accuracy of the aforesaid English translation.
6 FBA, Section 23.
7 FBA, Section 12.
8 This exemption is available for a few categories of businesses only (i.e., agency or brokerage for international trade, domestic retail of goods and domestic wholesale of goods under List Three (11), (14) and (15), respectively).
9 FBA, Sections 10 and 11. Currently, there are only five treaties in this regard: the Treaty of Amity and Economic Relations Between the Kingdom of Thailand and the United States of America; the Japan–Thailand Economic Partnership Agreement; the Thailand–Australia Free Trade Agreement; the ASEAN Comprehensive Investment Agreement; and the ASEAN Framework Agreement on Services.
10 Four ministerial regulations have been issued to date, exempting 12 categories of business activities, notably securities, banking and insurance businesses, and limited businesses between related parties.
11 FBA, Section 14.
12 Agricultural Land Leases Act 1981, Section 5/2.
13 Tourism Business and Guides Act 2008, Section 17.
14 Industrial Estate Authority of Thailand Act 1979, Section 44.
15 Investment Promotion Act 1977, Section 27.
16 Land Code, Sections 97 and 98.
17 FBA, Section 36.
18 Emergency Decree on Foreigners' Working Management 2017, Section 8.
19 https://www.sec.or.th/EN/Pages/News_Detail.aspx?SECID=9017.
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21 2022 Annual Report of the Foreign Business Commission, page 14: https://www.dbd.go.th/download/foreign_file/pdf/AnnualReport_FBA_2022.pdf.
22 FBA, Section 17.
23 FBA, Section 21.
24 FBA, Section 18 and ministerial regulations dated 17 May 1973.
25 FBA, Sections 17 and 20.
26 A foreign business certificate must be obtained when a foreigner is qualified for an exemption by means of an approval from the BOI or the IEAT or under a certain treaty. However, if a foreigner is otherwise exempted from restrictions under the minimum capitalisation rules or under relevant ministerial regulations, a foreign business certificate is not required and the foreigner may engage in the exempted business immediately from the date of full qualification for the applicable exemption.
27 FBA, Section 12.
28 2022 Annual Report of the Foreign Business Commission, page 22: https://www.dbd.go.th/download/foreign_file/pdf/AnnualReport_FBA_2022.pdf.
29 FBA, Section 8(1).
30 See https://www.dbd.go.th/dbdweb_en/download/pdf_law/FOREIGN_BUSINESS_ACT_BE2542/act/1FBA-FINAL[1].pdf. Note that only the official Thai version of the FBA has legal effect. The English translation is provided here simply for the convenience of readers. We do not in any way confirm the accuracy of the aforesaid English translation.
31 Land Transport Act 1979, Section 24(3).
32 FBA, Section 36.
33 Trade Competition Act 2017, Section 51.
34 2022 Annual Report of the Foreign Business Commission, page 40: https://www.dbd.go.th/download/foreign_file/pdf/AnnualReport_FBA_2022.pdf.

Chapter 23

Turkey

Bahadır Balkı, Erdem Aktekin, Nabi Can Acar and Seda Eliri[1]

Summary

I OVERVIEW

The primary legislation governing foreign investment in Turkey is the Foreign Direct Investment Law No. 4875 (the FDI Law), which was enacted in 2003. This legislation serves as the foundational pillar for foreign investment, encompassing provisions relating to investment procedures, investor rights and dispute resolution and guarantees the principle of equal treatment.

The FDI Law changed the permission and approval system that had been applied to FDI into an information system. Under the FDI Law, foreign investors are required to make certain types of mandatory notifications (FDI notifications) to the General Directorate of Incentive Implementation and Foreign Investment. However, these notifications are required not for the purposes of obtaining a permission from the Directorate but rather for informative purposes. Therefore, the FDI Law does not stipulate a sanction in cases of failure to notify. Instead, its sole purpose is to serve as a tool for keeping track of FDI.

This simplified procedure for foreign investment was adopted to establish a much more investor-friendly environment. Foreign investors are permitted to make investments in Turkey unless otherwise stipulated in a few specific laws or international treaties, and they will be treated on an equal basis with Turkish investors.

The most prominent exception to this equal treatment principle is in terms of transactions involving certain real estate. Accordingly, under to the Military Forbidden Zones and Security Zones Law No. 2565, foreigners (alongside other limitations explained in greater detail under Section IV) may not acquire properties in military forbidden zones. In order to ensure screening in terms of this prohibition, the FDI regime embeds an automated review process (the real estate review process), which is triggered in cases where companies with foreign shareholdings acquire companies that hold real estate in Turkey.

Since the FDI Law was introduced in 2003, cumulative FDI inflows to Turkey have exceeded US$251 billion. Through this 20-year period, the top four sectors receiving FDI inflows have been financial services (31.6 per cent), manufacturing industries (24.2 per cent), energy (10.6 per cent), and information and communication technologies (8.8 per cent).[2]

II YEAR IN REVIEW

In 2022, FDI inflows amounted to US$13 billion, outflows from direct investment made abroad were US$5 billion and net inflows amounted to US$8.1 billion, 17.4 per cent higher than 2021's level. Excluding real estate investments, net capital inflows from direct investments amounted to US$1.8 billion.[3]

Turkey's FDI regime is based on the approach of providing an investor-friendly environment for foreign investors. Turkey has not wavered from this approach for more than 20 years. Therefore, it is anticipated that an investor-friendly approach will be maintained for the foreseeable future.

III FOREIGN INVESTMENT REGIME

i Policy

The main policies governing the FDI regime in Turkey are investment liberalisation and the principle of equal treatment, which means that it is permitted for foreign investors to make investments in Turkey on equal terms with Turkish investors.

As mentioned, the sole purpose of FDI notifications is to keep track of foreign investments in Turkey. Since an FDI notification itself does not trigger a review process, there is no standard used to screen foreign investments.

However, acquisitions by companies with foreign shareholdings owning real estate in Turkey may be an exception to these principles (the real estate review process). The real estate review process aims to determine whether any real estate is located in or near any military zones, military security zones, strategically important zones or special security zones.

ii Laws and regulations

The FDI Law is the main legislation regulating foreign investment in Turkey. This legislation is supported by the Regulation on the Implementation of the Foreign Direct Investments Law (the Regulation). In addition to these main pillars of the Turkish FDI regime, there are special laws containing provisions on foreign investment. These special laws, whose relevant provisions will be explained in more detail under Section IV, in this regard are:

- the Regulation on Commercial Air Transport Operations (SHY- 6A);
- the Regulation on Airport Ground Handling Operations (SHY-22);
- the Law on the Establishment and Broadcasting Services of Radio and Television Institutions No. 6112;
- the Cabotage Law No. 815;
- the Military Forbidden Zones and Security Zones Law No. 2565;
- Law No. 6326 on Petroleum;
- Law No. 4737 on Industrial Zones;
- Law No. 2634 on Incentivizing Tourism; and
- Banking Law No. 5411.

The government body that oversees foreign investment is the General Directorate of Incentive Implementation and Foreign Investment (the Directorate). The Directorate is also responsible for the regulation and implementation of investment incentive measures. The Directorate operates under the Ministry of Industry and Technology.

In addition, the Investment Office of the Presidency of the Republic of Turkey has an important role for foreign investors. It is the official organisation that promotes the investment environment, provides assistance to investors and reports directly to the President of the Republic of Turkey. It works with a one-stop-shop approach and enables foreign investors to handle bureaucratic procedures more easily.

iii Scope

It should be noted that an FDI notification does not trigger any review process but does trigger a notification obligation.

Under the FDI Law, for an investment to trigger an FDI notification obligation, the investment shall be deemed an FDI, which is defined under Article 2 of the FDI Law as follows:

- establishing a new company or branch of a foreign company by a foreign investor; and
- share acquisitions of a company established in Turkey (any percentage of shares acquired outside the stock exchange or 10 per cent or more of the shares or voting power of a company acquired via the stock exchange) by the use of, but not limited to, the following economic assets:
  - assets acquired from abroad by the foreign investor: (1) capital in cash in the form of convertible currency bought and sold by the Central Bank of the Republic of Turkey; (2) stocks and bonds of foreign companies (excluding government bonds); (3) machinery and equipment; and (4) industrial and intellectual property rights; and
  - assets acquired from Turkey by foreign investors: (1) reinvested earnings, revenues, financial claims or any other investment-related rights of financial value; and (2) commercial rights for the exploration and extraction of natural resources.

iv Voluntary screening

For all transactions that fall under the regime, filing a notification is mandatory. While notification is mandatory, FDI notification does not trigger a review process, and the FDI Law and the Regulation do not stipulate a sanction in cases of failure to notify.

v Procedures

The implementation regulation of the FDI Law stipulates the following types of FDI notification obligations:

- companies and branch offices subject to the provisions of the FDI Law shall submit to the Directorate via the online electronic incentive application and foreign investment information system (E-TUYS) information on:
  - their capital and operations by the end of May each year;
  - the payments made to their equity accounts within one month following the payment; and
  - share transfers made between current domestic or foreign shareholders or to any domestic or foreign investors outside the company within one month of the realisation of the share transfer; and
- if domestic companies become subject to the provisions of the FDI Law via (1) participation of a foreign investor in the company or (2) participation of a foreign investor in the company that is not already a shareholder of the company during the capital increase of the company, they shall submit the share transfer information within one month of the realisation of the share transfer.

Furthermore, since the only purpose of the notification is informative, approval from the Directorate is not needed as a result of the notification. The mere fact that the notification has been made is sufficient to fulfil the requirement. Therefore, an appeal procedure is not designated.

vi Prohibition and mitigation

As the FDI regime in Turkey is a system for providing information rather than a permission and approval system, the Directorate does not approve or reject the transaction when it receives the FDI notification.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

Foreign investors are free to invest in all areas that are open for investment. In other words, there is no particularly prohibited sector for foreign investors.

ii Restricted sectors

Civil aviation

SHY-6A and SHY-22 (for A and C type licences only) stipulate that the majority of the shares of the relevant company (i.e., above 50 per cent) must be held by, and the majority of the directors must be, Turkish citizens.

TV broadcasting

The Law on the Establishment and Broadcasting Services of Radio and Television Institutions No. 6112 stipulates the following:

- the total direct foreign capital share in a media service provider shall not exceed 50 per cent of the paid-in capital;
- a foreign real or legal entity can directly become a shareholder of up to two media service providers; and
- if foreign real persons or legal entities hold shares in companies that are shareholders of media service providers and become indirect shareholder of the broadcasters, the chair, the deputy chair and the majority of the board of directors and the general director of the broadcasting companies must be Turkish citizens, and the majority of the votes in the general assemblies of broadcasting companies should belong to Turkish

citizens or legal entities outside the scope of the FDI Law. In the main contracts of such corporations, the arrangements ensuring these provisions shall be stated clearly. Failure to fulfil this obligation could lead to the broadcasting licence being revoked by the Radio and Television Supreme Council.

Maritime

Cabotage Law No. 815 stipulates that foreign ships are not entitled to engage in trade activities or to transport goods or passengers between Turkish ports within the territorial waters of Turkey.

Real estate

The following restrictions and prohibitions on the acquisition of real estate in Turkey are in place:

- for real persons:
  - under the Military Forbidden Zones and Security Zones Law No. 2565, foreigners may not acquire properties in military forbidden zones;
  - a foreign real person may acquire properties and restricted real rights of up to 30 hectares maximum; and
  - the total area of properties acquired by foreign real persons and independent and continuous limited real rights may not exceed 10 per cent of the surface area of the subject district of the private property; and
- for legal entities:
  - via a Turkish legal entity: if a foreign shareholder acquires 50 per cent or more of the shares or the right to appoint or dismiss the majority of the members of the board of directors of a Turkish company with full local shareholding, the Ministry of Treasury and Finance will inform the General Directorate of Land Registry and Cadastre of such change, and, subsequently, such Directorate will advise the relevant governorship to evaluate whether the Turkish entity (now with foreign shareholding) can own real estate (immovables) in Turkey. If real estate is located in or near military zones or other security zones, the relevant governorship may request that the company provide additional documentation and may eventually require the company to sell such real estate. On the other hand, Turkish companies with foreign shareholdings of at least 50 per cent or a foreign shareholder that has the right to appoint or dismiss the majority of the members of the board of directors of a Turkish company are required to file an application in order to acquire real estate in Turkey (real estate notification) with the Provincial Directorate of Planning and Coordination (PDPC) at the local governor's office where the real estate is located and receive a prior written consent. Once granted a positive response from PDPC, they should then apply to the Land Registry Directorate; and
  - real estate ownership directly by a foreign entity: companies with legal personality incorporated in accordance with laws of foreign countries can acquire real property or right *in rem* only according to the provisions of special laws (i.e., Law No. 6326 on Petroleum, Law No. 4737 on Industrial Zones and Law No. 2634 on Incentivizing Tourism). Any legal entity apart from companies established in other countries, such as foundations, organisations, associations or similar entities, cannot acquire real property or *in rem* rights.

V TYPICAL TRANSACTIONAL STRUCTURES

As the FDI Law is based on the principle of equal treatment, foreign investors have the same rights and are therefore subject to the same obligations as local investors. Foreign investors are subject to the same regulations regarding business registration and share transfers as local investors. Any type of company stipulated by the Turkish Commercial Law may be established by foreign investors. These types of companies include corporate forms such as a joint-stock company or a limited liability company and non-corporate forms such as a general partnership, limited partnership or partnership limited by shares. A company may be established at a Trade Registry Directorate found in Chambers of Commerce, and the procedure is wrapped up in a single day.

However, it should be highlighted that asset purchase would bring additional review processes for foreign investors. As mentioned above, there are restrictions and prohibitions on the acquisition of real estate in Turkey by foreigners. Therefore, if the transactions involve an asset purchase that also entails an immovable, rules regarding real estate purchase should be taken into account.

VI OTHER STRATEGIC CONSIDERATIONS

As the Turkish FDI regime is itself very open to foreign investors, sector-specific regulations described above and Turkish competition law are the issues to be considered.

Turkey's merger control regime is aligned with the European Union's regime in general. The following mergers and acquisitions will require authorisation from the Turkish Competition Authority under the current Turkish merger control regime:

- transactions where total Turkey turnover of transaction parties exceeds 750 million Turkish lira (approximately[4] €43.15 million or US$45.28 million[5] for 2022) and where the Turkey turnover of at least two of the transaction parties separately exceeds 250 million lira (approximately €14.38 million or US$15.09 million for 2022); and
- in acquisitions, assets or operations that are subject to the acquisition and in mergers, where Turkey turnover of at least one of the transaction parties exceeds 250 million lira and global turnover of at least one of the other transaction parties exceeds 3 billion lira (approximately €172.61 million or US$181.15 million for 2022, if 2022 turnovers are available).

The aforementioned merger control regime also has an exception in terms of 'technology undertakings'. The technology undertaking provision that was introduced back in March 2022 stipulates an exception to certain thresholds to catch 'killer acquisitions'. According to the exception, the 250 million lira threshold that is mentioned under the two tests of the thresholds are not applicable in the acquisitions of technology undertakings that (1) are active, (2) have research and development activities in the Turkish geographical market or (3) provide services to customers in Turkey. Technology undertakings are defined as undertakings active in areas of digital platforms, software and gaming software, financial technologies, biotechnology, pharmacology, agrochemicals and health technologies.

In addition, given that foreign investors are treated equally to Turkish investors, standard conditions and notification obligations applying to Turkish real persons or legal entities are also applicable for foreign investors. In the mining, petroleum and natural gas, heavy manufacturing industry, telecommunications, energy, tourism, retail, health industry, waste management and private security sectors, there are additional notification requirements.

However, only the procedures specifically designed for foreign investors are explained hereinafter.

i Banking

Banking operations are overseen by the Banking Regulation and Supervision Agency (BRSA). Therefore, the establishment of a branch of a foreign bank in Turkey is also subject to BRSA's approval.

The BRSA's evaluation is dependent on certain requirements under Banking Law No. 5411 (the Banking Law) as follows:

- the bank's primary activities must not have been prohibited in the country where its headquarters are located;
- the supervisory authority in the country where the bank's headquarters are located should not have an unfavourable view of its operations in Turkey;

- the paid-in capital reserved for Turkey should not be less than the amount set out in the banking law;
- the members of the board of directors should have adequate professional experience to be able to satisfy the requirements laid down in corporate governance provisions and perform the planned activities;
- it must submit a programme of activities covered by the permission, the budgetary plan for the first three years and its structural organisation; and
- the group, including the bank, must have a transparent partnership structure.

A branch of a foreign bank is entitled to conduct all banking activities stated under the banking law and is treated the same as a Turkish bank licensed by the BRSA.

ii Insurance

Insurance companies and reinsurance companies are required to obtain a licence from the Ministry of Treasury and Finance for each insurance branch in which they wish to operate. Foreign direct investors are additionally required to obtain a licence to open a branch in Turkey. The conditions for this licence are regulated by the Regulation on the Establishment and Operating Principles of Insurance Companies and Reassurance Companies.

VII OUTLOOK

Since the current FDI Law entered into force, an investor-friendly approach is embraced. As with any country, one of the top priorities is to attract more foreign investment. The government's commitment to providing incentives demonstrates its determination to create a conducive environment for foreign investment. As a result, there are no foreseen changes in the current FDI regime in the near future.

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2 https://www.invest.gov.tr/en/whyturkey/pages/fdi-in-turkey.aspx.
3 TEPAV, Direct Investment Bulletin 2022 IV, 2023.
4 The euro figures are converted using the exchange rate of €1 equals 17.38 lira, based on the applicable Central Bank of the Republic of Turkey average buying rate for 2022.
5 The US dollar figures are converted using the exchange rate of US$1 equals 16.56 lira, based on the applicable Central Bank of the Republic of Turkey average buying rate for 2022.

Chapter 24

United Kingdom

Alex Potter, Kaidy Long and César Manivet[1]

Summary

I OVERVIEW

In recent years, major developments in geopolitics, technology and global supply chains have led to growing concerns in the United Kingdom that foreign investment could be used to undermine national security interests. In response to these developments, the government introduced a new UK national security screening regime under the National Security and Investment Act 2021 (the NSI Act), which came into force on 4 January 2022 and replaced the previous system for national security scrutiny under the Enterprise Act 2002 (EA02). Under the EA02 regime (which remains in place for some sectors – see below), grounds of review were limited and interventions were relatively rare. The NSI Act brings the United Kingdom closer in line with developments seen in several other countries, including the United States, other Five Eyes allies (Australia, Canada and New Zealand) and certain Member States in the European Union. Since its commencement, the number of transactions screened by the government on national security grounds has vastly increased and touches on a much broader range of sectors. Although not billed as a foreign investment regime – the NSI Act also applies to British investors – it was conceived out of the government's review of its powers in relation to foreign investment and national security.

i Key elements of the UK national security screening mechanism

The NSI Act, which can also extend to certain investments outside the United Kingdom (discussed below), has three key aspects:

- mandatory notification of transactions in 17 strategically sensitive sectors;
- voluntary notification of transactions that are not subject to mandatory notification; and
- for transactions outside the mandatory notification system, powers for the UK government to call them in for review up to five years after the closing of the relevant transaction.

Although an investor must acquire some form of material influence or control over the target entity or asset for the transaction to be reviewable (discussed in Section III, below), the NSI Act does not have any notification thresholds or safe harbours based on a target's turnover or other indication of significance in the United Kingdom, meaning that transactions with very limited nexus to the United Kingdom can be caught. Internal reorganisations can also be caught. It suffices for a target entity to carry on activities in the United Kingdom or to supply goods or services of any amount to persons in the United Kingdom. The broad scope of the NSI Act resulted in 866 notifications being submitted during the 2022–2023 financial year (which largely equates to between 60 and 80 notifications per month).[2] According to government statistics, the vast majority (92.8 per cent) of notifications that were reviewed during that period were cleared quickly, without the need for an in-depth review,[3] confirming its expectation that only a small proportion of transactions would merit detailed assessment and even fewer would require remedies (see Section II, below).[4] The creation of a more structured process for notifying and assessing transactions for national security issues has also provided investors with some welcome procedural and timing certainty. However, the government has recognised that the regime still needs to be more open and transparent in how it scrutinises deals, in light of pressure to improve communications with industry and increase transparency for the market.[5]

In the 2022 annual report published by the Department for Business, Energy and Industrial Strategy (BEIS, the ministerial department originally responsible for administrating the new regime) (the NSI Annual Report 2022), BEIS stated:

> *The powers in the NSI Act ensure investment in the UK can continue with predictability and transparency*[6] *whilst protecting national security. These new powers are an upgrade from the Enterprise Act 2002 – which was principally focussed [sic] on competition rather than national security – to help cope with the changing demands of the modern world.*[7]

ii Other statutory frameworks

In addition to the NSI Act, there are some additional review frameworks that may apply to investments into the United Kingdom:

- for transactions that meet the thresholds for review by the United Kingdom's competition law enforcer, the Competition and Markets Authority (CMA), the EA02 also enables the government to intervene based on a defined set of public interest considerations, namely media ownership and plurality, financial stability and the United Kingdom's ability to combat public health emergencies (unlike national security, in these areas of review, the domestic or foreign status of the investor tends to be of limited relevance).[8] The government may also specify additional public interest considerations where considered necessary. The NSI Act replaces the national security consideration previously contained in the EA02;
- for investments in regulated sectors,[9] additional licences, consents or authorisations may be required from the relevant government department or independent regulator;
- consent from the relevant ministerial department may be required when the target whose shares are being acquired is one of the few UK companies in which the government holds a special share (also called a golden share);
- certain investments may also be subject to the UK sanctions regime, notably when they involve Russian parties; and
- under Section 13 of the UK Industry Act 1975, the Secretary of State (SoS) can prohibit foreign takeovers of an 'important manufacturing undertaking' that are against the interests of the United Kingdom or a substantial part of it. There is no public record of this provision having ever been used to block an acquisition of a UK business since its enactment.

Details of these regimes and additional controls are outside the scope of this chapter (although their potential applicability should be investigated prior to undertaking investment activities).

iii Political interventions and voluntary undertakings

Although the NSI Act has considerably upgraded the government's powers to review investments that raise national security concerns, when a UK target is likely to be strategically important or attract a high profile in terms of media or political interest (or both), the government has sometimes sought additional assurances from an investor to allay its concerns around the change in ownership, irrespective of its statutory powers to intervene. These generally take the form of voluntary economic undertakings relating to the future management, structure and investment of the target, as well as the target's position in the broader economy. When the target is a UK public company, the government has sometimes, with the agreement of the Panel on Takeovers and Mergers (the Takeover Panel), asked for such undertakings to be recorded as legally binding 'post-offer undertakings' enforced by the Takeover Panel.[10] In other cases, investors have been asked to provide informal assurances or enter into deeds of undertakings with the relevant ministerial department. Prominent examples of political interventions that have resulted in binding undertakings being offered voluntarily include *Cobham/Ultra*,[11] *Parker-Hannifin/Meggitt*[12] and *Viasat/Inmarsat*[13] (all from 2022).

Investors should be alert, therefore, to the risk of this type of additional government pressure, which may sometimes be amplified by the requirements of the board of directors of a publicly listed UK target business, whether or not a review of investments of this nature under the NSI Act is triggered.

II YEAR IN REVIEW

The NSI Act received royal assent on 29 April 2021 and entered into force on 4 January 2022. The regime is administered by the Investment Security Unit (ISU) within the Cabinet Office. Based on ISU activity during the past year, there are several key themes that can be drawn out and that set the tone for the government's enforcement strategy under the NSI Act.

i Increase in national security interventions

The key takeaway from the past year is that the government is increasingly active in intervening in transactions on national security grounds. While this trend can already be observed from recent years,[14] in the first full financial year of the NSI being in force (2022–2023), 65 transactions were called in for an in-depth assessment (out of a total 766 transaction screened by the ISU) – a significant increase from pre-NSI times.[15] During that same period, the ISU imposed final orders (i.e., imposed remedies or ordered a transaction to be blocked or unwound) in a total of 15 cases, with 10 transactions being cleared subject to remedies and five being blocked or unwound.[16]

The proposed acquisition of ARM, a UK-based company that develops and licenses semiconductor intellectual property, by Nvidia, a US-based company that supplies semiconductors (in 2022), was the first transaction referred for an in-depth Phase II national security review under the previous EA02 regime.[17] The government's decision to refer was particularly notable given that prior national security interventions, including in the defence sector, were cleared by the government (either conditionally or unconditionally) without the need to open a Phase II investigation.[18] Furthermore, ARM was at the time of the proposed acquisition already owned by a foreign investor (Softbank, based in Japan) that, in relation to its prior takeover of ARM (in 2016), had already committed to a range of voluntary economic undertakings with the government.[19]

Since 2022, the government has also used its powers for the first time to formally block five transactions on national security grounds using the NSI Act.[20] Several transactions also involved the imposition of remedies to mitigate national security concerns, under either the former EA02 regime – such as (1) Cobham's acquisition of UK defence company Ultra Electronics Holdings plc (which involved more stringent requirements than in previous cases) and (2) Parker-Hannifin's takeover of UK aerospace company Meggitt PLC – or under the NSI Act, including Epiris's acquisition of Sepura (a company that supplies digital radio systems used by the UK emergency services), which was the first transaction subject to formal remedies under the NSI Act.[21] Subsequent transactions that have been subject to remedies under the NSI Act are set out in full below[22] and include, most recently, the acquisition of GE Oil & Gas Marine & Industrial UK Ltd and GE Steam Power Ltd (which provide critical national security and defence capabilities relating to naval propulsion systems) by EDF Energy Holdings Ltd.[23]

This increased scrutiny from the government has also led to deals being abandoned, the latest of which was the proposed acquisition of Electricity North West, the power network operator for the North West of England, by Redrock Investment Limited (a Chinese-owned investor), which was aborted in December 2022 shortly after the SoS issued a final order).[24]

ii Scrutiny across a wider range of sectors

According to the annual report published by the Cabinet Office in July 2023 (the first such report on the NSI Act regime to cover a full year) (the NSI Annual Report 2023), transactions involving defence and military companies still command the most attention, with 66 per cent of the 65 deals called in for an in-depth assessment being associated with the military, dual-use and defence sectors (and 29 per cent dealing with advanced materials, which include semiconductors).[25]

However, it is notable that a broader range of sectors have seen deals with remedies imposed. Of the 15 cases where final orders (i.e., remedies) were imposed, the sectors are more evenly spread: targets with activities in the military and dual-use and communications sectors received four each, and three went to targets active in each of the energy, defence, computing hardware and advanced materials sectors (note that deals can relate to more than one sector).[26] Investors should therefore take note that the government is identifying national security risks in a broader range of sectors and imposing (often onerous) remedies on the businesses involved, particularly those in advanced technology or critical infrastructure sectors.

iii Small increases in stakes also drawing attention

The government has also been reviewing more incremental transactional activity that builds on existing ownership in UK-based assets and companies. According to press reports, the government investigated whether WindAcre's purchase of an additional stake in Nielsen Holdings (bringing its total holdings to 27 per cent) should have been notified under the NSI Act.[27] As explained below, investors are required to make a notification if an investment results in them holding a stake of more than 25 per cent in companies in specified sectors, such as artificial intelligence, in which Nielsen has invested for years. The ISU also reviewed Altice's purchase of a further 6 per cent of shares in BT Group, which brought its stake up to 18 per cent and allowed it to make a takeover bid for BT.[28] Both cases were ultimately cleared without remedies being imposed, but they nonetheless show that the government will intervene even under such circumstances.

In addition to the above, there have been 'behind the scenes' developments relating to the general running of the NSI Act regime that are of wider importance.

iv A new decision maker in government

At the time the NSI Act entered into force, the ministerial department responsible for administrating the new regime was BEIS, and the SoS for BEIS was the final decision maker. Following a departmental reshuffle in February 2023, the government decided to restructure BEIS. As part of this, the ISU was also repositioned within the Cabinet Office. The final decision maker for the NSI regime is now the SoS in the Cabinet Office (currently Oliver Dowden, the UK Deputy Prime Minister). Despite these structural changes, there is no sign that this has had an impact on the ISU's enforcement policy or on the outcome of reviews themselves. However, it indicates that the most central part of government wishes to have more immediate oversight over operation of the NSI Act regime.

v Improved guidance and transparency

The government published more guidance in April 2023 on (1) when to notify, (2) whether to notify and (3) notifications affecting companies in financial distress – which has also provided further clarity on how to expect the regime to operate in practice.[29] The NSI Annual Report 2023 has also provided additional information (both beyond the statutory minimum and as compared with the NSI Annual Report 2022) regarding the operation of the regime.[30]

vi More parliamentary scrutiny

The past year has also seen the BEIS Sub-Committee on National Security and Investment be set up to examine the work of the ISU and to provide independent oversight.[31] A memorandum of understanding was agreed in March 2023 between the Sub-Committee and the government, which facilitates the Sub-Committee's access to the information it needs to scrutinise the ISU's work – including on individual cases.[32] The Sub-Committee has the powers to require the attendance of witnesses and the production of papers and other material – though these formal powers are expected to be used only rarely. Nevertheless, it points to the fact that the ISU's work – and the NSI regime more generally – will be under formal review by parliamentary legislators, which may lead to potential changes to the NSI Act if deemed necessary.

III FOREIGN INVESTMENT REGIME

i Policy

The NSI Act will be used by the government to screen transactions for national security issues. Despite its broad scope, the government has stressed that most acquisitions will not raise national security concerns and that the NSI Act cannot be used for economic or political purposes.[33] Nevertheless, it is important that investors carry out a thorough filing and risk assessment, particularly for transactions in any of the 17 mandatory sectors or that otherwise involve a sensitive target or asset that could trigger national security concerns.

ii Laws and regulations

The primary legislation is the NSI Act, which entered into force on 4 January 2022. The NSI Act is administered by the ISU within the Cabinet Office, and the SoS is the final decision maker.

For transactions that do not meet the thresholds for mandatory notification, there is formal government guidance on how the SoS expects to use the relevant powers to call in transactions (the Call-In Power Statement). Certain details around the administration of the regime are also prescribed in secondary legislation, such as the form and content of notification forms, the calculation of monetary penalties for non-compliance and the process for sending and receiving documents under the NSI Act.[34] The government has also published additional guidance on certain topics under the NSI Act, which is available on the government's website.

Interaction with other regimes

The NSI Act regime is entirely separate from any review of competition issues by the CMA pursuant to its merger control powers under the EA02. When a transaction is reviewable under both regimes, competition and national security reviews will run under separate processes, although the ISU and the CMA are expected to work closely together to manage such cases (e.g., where appropriate, aligning the two processes to avoid conflicting remedies being imposed (or accepted) under the NSI Act and the CMA's competition review under the EA02. However, remedies imposed by the SoS under the NSI Act will take precedence over any action taken by the CMA in connection with its competition review).[35]

The public interest regime under the EA02 will continue to be the formal statutory framework for the government to intervene in transactions that raise concerns in relation to non-national security public interest considerations (media ownership and plurality, financial stability and the United Kingdom's ability to combat and mitigate the effects of public health emergencies – the government can specify additional grounds). There will be no overlap between the new NSI Act and the national security aspects of the EA02 regime that the NSI Act has replaced: a merger that has previously been subject to a national security intervention under the EA02 cannot be called in under the NSI Act.[36]

The NSI Act regime is also expected to operate in tandem with other regulatory regimes in the United Kingdom, such as the Takeover Code, UK export controls and financial services regulations. Interactions between the NSI Act and the CMA's merger control regime or other regulatory regimes will be facilitated through memoranda of undertaking and the exchange of information between other enforcement authorities and the ISU.[37]

iii Scope

The NSI Act applies where arrangements that bring about the acquisition of control of a qualifying entity or qualifying asset (called a trigger event) have occurred or are in progress or contemplation. Specifically:

- a 'qualifying entity' includes any entity that is not an individual and includes a company, any other body corporate, a partnership, an unincorporated association or a trust.[38] Foreign entities are caught if they carry on activities or supply goods or services to persons in the United Kingdom;[39] and
- a 'qualifying asset' is defined widely to include not only land and tangible property but also ideas, information or techniques that have economic value (e.g., software, trade secrets, databases, algorithms and designs).[40] Licences to use the target's intellectual property or know-how, for example, could be considered a qualifying asset. Physical

property located outside the United Kingdom is captured if it is used in connection with activities carried on in the United Kingdom or the supply of goods or services to persons in the United Kingdom.[41]

The requisite level of control obtained for a transaction to be reviewable under the NSI Act differs depending on whether the transaction is subject to mandatory notification and whether the target is an entity or asset (see below). As noted above, there are no notification thresholds regarding turnover, asset value, share of supply or market share in either case.

Transactions subject to mandatory pre-screening under the NSI Act

The mandatory notification regime applies to investments in 17 designated sectors (this excludes asset-only acquisitions, which may nonetheless be reviewed by the government using its call-in powers or pursuant to a voluntary notification – see further below). Details of the relevant sectors are set out in the National Security and Investment Act 2021 (Notifiable Acquisition) (Specification of Qualifying Entities) Regulations 2021 and accompanied by official guidance explaining what is within and outside the scope of each of these sectors.[42] The 17 sectors are:

- advanced materials;
- advanced robotics;
- artificial intelligence;
- civil nuclear;
- communications;
- computing hardware;
- critical suppliers to government;
- cryptographic authentication;
- data infrastructure;
- defence;
- energy;
- military and dual-use items;
- quantum technologies;
- satellite and space technologies;
- suppliers to the emergency services;
- synthetic biology; and
- transport.

Any investments in qualifying entities active in these sectors must be notified to the ISU for pre-clearance if they result in a person acquiring shares or voting rights that meet the following thresholds:

- transactions that bring a person's shares or voting rights in a qualifying entity (1) from 25 per cent or less to more than 25 per cent, (2) from 50 per cent or less to more than 50 per cent or (3) from less than 75 per cent to 75 per cent or more. This therefore covers acquisitions of incremental stakes in the same qualifying entity that result in a person's stake crossing any of the aforementioned thresholds; or
- acquisitions of voting rights that enable the acquirer to secure or prevent the passage of any class of resolution governing an entity's affairs.[43]

The government may amend the scope of transactions requiring mandatory notification, for example to include asset acquisitions[44] or to exempt certain types of acquirers.[45] However, at the time of writing, the government has not made use of this power.

Notifiable acquisitions that complete before receiving clearance will be legally void,[46] in addition to being liable for review under the NSI Act indefinitely (or six months from the date that the SoS became aware of the transaction)[47] (see further under Section III.v, 'Procedures', below).

Transactions subject to the SoS's call-in powers under the NSI Act

An investment that is not caught by the mandatory regime (e.g., an asset acquisition or an acquisition in a non-mandatory sector) is potentially reviewable if it involves a person acquiring control in a qualifying entity or asset. Any such transaction that involves acquisition of the requisite level of control can be either voluntarily notified by the parties or called in by the SoS.

This part of the regime covers a wider range of transactions:

- for investments in qualifying entities, in addition to acquisitions resulting in a level of control that can trigger a mandatory notification (see above), acquisitions that enable the acquirer to materially influence the policy of the target entity are also reviewable.[48] The government has confirmed that it will align with the CMA's guidance in assessing whether there has been an acquisition of material influence.[49] There is no bright line test for material influence: for acquisitions that do not exceed the lowest threshold of 25 per cent shares or voting rights for control, there can still be an acquisition of material influence if other factors are present, such as the acquirer's de facto ability to dictate the outcome of shareholder meetings (e.g., based on past patterns of shareholder attendance and voting), rights to obtain board representation, veto rights over strategic decisions in the target, and certain commercial or financial arrangements with the target that allow the acquirer to gain material influence over the target's policy. These factors are non-exhaustive and will be considered in the round in assessing material influence;[50] and
- investments in qualifying assets are reviewable if they involve the acquisition of a right or interest that gives the acquirer the ability – or enhances its ability – to use the asset or direct or control how the asset is used.[51]

Transactions not notified under the voluntary procedure that the SoS reasonably suspects has given rise to, or may give rise to, a risk to national security can be called in up to five years post-completion, provided that the call-in power is exercised within six months of the SoS becoming aware of the transaction.[52]

Transactions entered into before the NSI Act came into force

Mandatory notification requirements apply only to transactions completed on or after the NSI Act entered into force (i.e., 4 January 2022). However, qualifying transactions that have closed as early as 12 November 2020 of which the SoS became aware on or after 4 January 2022 can still be called in within five years of the commencement date or (if earlier) within six months of the SoS becoming aware. Transactions brought to the attention of the SoS before the commencement date can no longer be called in under the NSI Act.[53]

iv Voluntary screening

Transactions that qualify to be called in by the SoS may be voluntarily notified by the parties under the NSI Act. This applies only to transactions that are not subject to mandatory notification requirements.

There is no statutory definition under the NSI Act that would give investors clear comfort as to what constitutes, or falls outside, the concept of national security, which will be assessed case by case.[54]

The primary official guidance that investors and businesses can rely on is the Call-In Power Statement, which may be amended from time to time by the SoS. The current version sets out a three-pronged approach to assessing national security risks, which takes into account the combined risk profile of:

- the target (in particular if the target is active in, or has close links to, any of the 17 sensitive sectors);
- the acquirer (such as its existing activities and holdings, its ultimate controller and any links to a hostile state or organisation); and

- the type or level of control acquired.[55]

To assist parties in deciding whether to notify a transaction, the government has also published market guidance notes that seek to provide advice to potential investors on common questions regarding whether and how to notify a transaction under the NSI Act.[56]

Additional considerations

For transactions not subject to mandatory notification but at risk of being called in, the voluntary notification procedure can be used to increase deal or timing certainty. Where a transaction is notified, the five-year window for the SoS to call in a transaction post-completion is reduced to 30 working days from submission of a complete voluntary notification. There can be only one call-in notice per transaction, unless false or misleading information has been provided by the parties.[57]

In addition, recent government guidance has clarified that if there is significant uncertainty about whether an acquisition is notifiable, parties may contact the government to seek a view. While the government will endeavour to be as helpful as possible, there will be circumstances in which it may not be possible or appropriate for the government to give a substantive response. In particular, the ISU considers that it is unlikely to comment on hypothetical scenarios as they may be misapplied to similar but substantially different real scenarios.[58]

According to the NSI Annual Report 2023, the ISU received almost four times as many mandatory notifications as voluntary notifications during the 2022–2023 financial year (671 mandatory notifications compared with 180 voluntary notifications).[59]

v Procedures

Party responsible for notification

When a transaction falls under the mandatory notification regime, the obligation to notify lies with the person gaining control over the qualifying entity (typically the acquirer).[60]

Failure to gain the requisite pre-clearance will void a completed transaction and may result in significant penalties, including:

- for businesses: a fixed penalty of up to 5 per cent of worldwide turnover or £10 million (whichever is greater);[61] or
- for individuals: a fixed penalty of up to £10 million and imprisonment for up to five years.[62]

A completed transaction that is void on this basis can be rendered valid again subsequently if cleared by the SoS, either following an application from any person materially affected by the fact that the acquisition is void or if the SoS otherwise becomes aware of the transaction (following which the SoS is required either to call in the transaction or to validate it retroactively).[63] During the 2022–2023 financial year, 12 retrospective validation applications were accepted.[64]

A voluntary notification, however, can be made by the seller, the acquirer or a qualifying entity.[65]

Review time frames

The time frames for a review under the NSI Act are as follows:

- once a transaction has been notified (whether on a mandatory or voluntary basis), the SoS will decide as soon as reasonably practicable whether to accept or reject the notification.[66] There is no statutory time limit but, typically, the decision is made within four to five working days, particularly for straightforward cases. This can be longer if the ISU requests clarificatory information before choosing to accept a notification as complete, or if the ISU chooses to reject the notification;[67]
- once a notification is accepted, an initial screening period of up to 30 working days;[68]

- for transactions that have been called in for a full review – either following the initial screening or pursuant to the government's call-in powers for non-notified transactions – an assessment period of 30 working days, with a possible extension of a further 45 working days (which will typically be invoked if remedies are being considered);[69]
- a further 'voluntary' extension of the assessment period can be agreed between the SoS and the parties (e.g., to agree the form and scope of remedies), but only where the SoS concludes that the transaction has given risen to, or would give rise to, a risk to national security;[70] and
- requests for information during the assessment period will automatically suspend the review period until the parties have responded.[71] This can extend timelines significantly as, in practice, the 'clock' can stop for several weeks (or even months) at a time.

According to the NSI Annual Report 2023, the average time the ISU takes to accept a notified transaction (thus commencing the initial screening period) is four to five working days, and the average time the ISU takes to call in a transaction once a notification has been accepted is 27 working days for mandatory notifications and 25 working days for voluntary notifications.[72]

Information required

There are separate forms for mandatory, voluntary or retrospective validation notifications, which are submitted via the ISU's online portal. The content of the notification form includes information regarding the transaction, the qualifying entity or asset and the acquirer (including details of their respective ownership structures). The notifying party is also required to confirm whether the target holds any UK security clearances, licences to operate in the United Kingdom, dual-use items, or government contracts or government-funded research and development (R&D) projects. The ISU may reject applications that contain insufficient information to allow it to decide whether to issue a call-in notice[73] or if it has been notified under the wrong procedure (i.e., mandatory, voluntary or retrospective validation). To date, a small number of notified transactions have been rejected on this basis.[74] Additional guidance on completing the form can be found in the ISU's market guidance notes.[75]

During the course of its review, the ISU also has wide-ranging powers to request additional information for its analysis via information and attendance notices. There are significant penalties for non-compliance with these notices, including a fixed penalty of up to £30,000 or a daily rate penalty of up to £15,000 per day.[76] An individual may additionally face up to two years' imprisonment.[77] There are similar sanctions for supplying false or misleading information to the ISU and for delaying, suppressing or obstructing the provision of information.

Interim measures

While a transaction is still under review, the SoS may issue interim orders where necessary and proportionate to prevent parties from taking pre-emptive action (such as completing a transaction) that might prejudice the imposition of remedies.[78] Although the SoS is not required to publish the fact that it has issued an interim order, according to press reports, at least one transaction has been suspended pursuant to such an order.[79] The SoS has exercised similar powers in the context of national security reviews under the EA02 regime.[80]

Investors contemplating global deals that have a connection to the United Kingdom should be mindful, therefore, of the potential extraterritorial effect of these interim measures, which could effectively freeze the transaction on a worldwide basis.

Possible outcomes

Following a national security assessment, the government will be able either to clear the transaction or, if following in-depth review the SoS believes that the acquisition is likely to pose a risk to national security, to impose a final order. The final order may stipulate certain remedies to mitigate national security concerns or it may block or unwind the acquisition.

The SoS has broad powers to impose any form of remedy considered necessary and proportionate to address any risk to national security. Examples of remedies applied in recent transactions, including those reviewed on national security grounds under the NSI Act and the previous EA02 regime, have included the following:

- restricting the number of shares or voting rights acquired;
- restricting the transfer or sale of intellectual property rights;
- requirements on board composition (including allowing a government-appointed board observer to observe meetings) or the appointment of key personnel;
- requirements on appointing an officer in charge of ensuring compliance with security measures;
- requirements to maintain existing strategic capabilities in the United Kingdom (e.g., under the control of UK companies);
- ring-fencing sensitive activities, information, technology or certain operational sites (e.g., implementing enhanced controls; providing assurances against foreign ownership, control or influence; providing rights of access to premises and information by relevant agencies to conduct compliance checks; or, in the case of *Cobham/Ultra* (2022), transferring sensitive assets to a separate entity, with the government having a role in board appointments and oversight over the operations of such entities);
- government approval rights over future divestments of sensitive capabilities;
- government step-in rights for breaches serious enough to jeopardise the fulfilment of critical Ministry of Defence (MoD) programmes;
- requirements to maintain the acquired entity's existing contracts and supply chain, including obligations to notify material changes to the target's supply capabilities under those contracts; and
- requirements to not take any action, or to refrain from taking any action, that could cause the target's sensitive UK capabilities to become subject to US export control under the US International Traffic in Arms Regulations (ITAR).[81]

As with interim orders, it is possible for the final order imposing remedies or blocking the transaction to have extraterritorial effect, provided that it is necessary and proportionate to address the national security risk.

The same penalties that apply to completing a transaction without gaining the requisite pre-clearance under the mandatory regime can apply in the case of failure to comply with a final order or interim order, namely:

- for businesses: a fixed penalty of up to 5 per cent of worldwide turnover or £10 million (whichever is greater);[82] and
- for individuals: a fixed penalty of up to £10 million and imprisonment for up to five years.[83]

Alternatively, or in addition, a person may face a daily penalty of up to £200,000 and a business may face a daily penalty of up to £200,000 or up to 0.1 per cent of worldwide turnover (whichever is greater).[84]

According to the NSI Annual Report 2023, of the 72 called-in acquisitions during the 2022–2023 financial year, 79.2 per cent (57) were cleared and 20.8 per cent (15) resulted in a final order. This means that a decision to call in a transaction does not necessarily indicate that remedies will be imposed.

On timing, for those transactions that ended up being cleared, the average time to reach a decision was 25 to 31 working days (excluding days during which requests for information were in force) – meaning that a majority of these did not require the use of the additional period for the ISU's assessment. For the transactions that resulted in a final order being imposed, the average time to reach a decision was 77 to 81 working days (excluding days during which requests for information were in force) – meaning that the additional period was used in several of these cases (given that the average number of working days to issue a final order is higher than 75 days).[85] Given that these time periods do not include days when the clock was stopped, investors should be cautious about drawing conclusions from these statistics: experience is showing that, for those deals that are called in (and particularly those where remedies are being considered), the time taken to conclude the review can be long and unpredictable.

Appeals

The NSI Act provides for an appeal process to the High Court based on judicial review principles, whereby appeals are brought against the lawfulness of a substantive decision or other decisions or actions by the SoS under the NSI Act. The exception to this is decisions relating to civil penalties, for which a full merits appeal will be available.[86] There is a limitation period of 28 days after the grounds to make the claim arose.[87]

As set out in further detail below, two cases are currently being appealed: *Nexperia/Newport Wafer Fab* and *L1T FM Holdings UK Limited/Upp Corporation Limited*. These cases are likely to involve a closed material procedure to protect sensitive matters in the proceedings – thereby shielding much information from public view. This process will make it difficult to assess precedent cases, including how the courts will approach or interpret any ground for a claim (or the application of the proportionality principle) within a national security context. It will also mean that even the parties to the case will have limited visibility to proceedings. Closed material procedures typically rely on 'special advocates' being used (i.e., individuals appointed to represent the claimant party's interests without having to disclose the sensitive information to that party, that party's legal counsel or the public). Delays to the procedures may stem from the appointment or availability of such individuals due to a limited pool of candidates.

vi Prohibition and mitigation

To date, there have been five prohibitions under the NSI Act (including transactions blocked or unwound) and 12 final orders imposing remedies on transactions. Details of these are summarised in the table below. As can be seen, the five transactions that were blocked or unwound largely dealt with advanced technologies; however, the more obvious common thread for these deals was the presence of Chinese or Russian links to the acquirer. This trend is likely to continue with respect to future deals.

With respect to transactions subject to remedies, the range of acquirer nationalities is broader and includes the United Kingdom and its allies. Similarly, the affected sectors in those 12 transactions covered communications (three cases); energy – battery storage and electricity generation or distribution (three cases); and, for the remainder, defence or dual use. From the limited information that is published in relation to these final orders, the mitigations to national security risks largely covered the protection of sensitive information, the maintenance of UK strategic capabilities and ensuring continuity of supply for critical UK programmes.

A number of national security interventions under the previous EA02 regime have also resulted in remedies to mitigate national security concerns, the last of which were concluded in 2022 (*Parker-Hannifin/Meggitt* and *Cobham/Ultra*).

	Parties	Sector	Acquirer	Outcome or remedies
	Transactions blocked or unwound since January 2022			
1	*Beijing Infinite Vision Technology/University of Manchester*	Dual-use technologies (vision sensing)	China	Blocked
2	*Pulsic Ltd/Super Orange HK Holding Ltd*	Dual-use technologies (electronic design automation)	Hong Kong/China	Blocked
3	*Nexperia/Newport Wafer Fab*	Advanced materials (semiconductors)	China	Order to unwind (decision subject to judicial review)
4	*SiLight (Shanghai) Semiconductors Limited/HiLight Research Limited*	Advanced materials (semiconductors)	China	Blocked
5	*L1T FM Holdings UK Limited/Upp Corporation Limited*	Communications (full-fibre broadband network)	Russian links	Order to unwind (decision subject to judicial review)

	Parties	Sector	Acquirer	Outcome or remedies
	Transactions subject to remedies since January 2022			
6	*Epiris/Sepura*	Communications; emergency services	UK (private equity)	Protect sensitive information and technology; maintain UK capabilities
7	*Tawazun Strategic Development Fund/Reaction Engines*	Dual-use technologies	UAE (fund)	Mitigate risks from dual-use technologies and sensitive intellectual property being accessed by hostile actors
8	*Stonehill asset development rights*	Energy (storage – battery)	China	Government approval of offtake operator; information sharing restrictions
9	*Viasat/Inmarsat*	Satellite technology	US	Restrictions on information access; maintain UK capabilities
10	*Iceman Acquisition Corp/CPI Intermediate Holdings*	Electronic components for communications and defence sectors	US	Maintain UK R&D and manufacturing capabilities
11	*Redrock Investment/Electricity North West*	Energy (electricity distribution)	China	Restrictions on information sharing and staff appointments
12	*Sichuan Development Holding/Ligeance Aerospace Technology/Gardner*	Aerospace	China	Information sharing restrictions, removal of certain board representatives, appointment of government observer
13	*Hakan Koç/Truphone*	Communications	Germany	Information security measures
14	*China Power International Holding Limited/XRE Alpha Limited*	Energy (electricity generation)	China	Government approval of offtake operator; information sharing restrictions
15	*Stellex Capital Management/ David Brown Santasalo*	Defence (gears and gear boxes)	US (private equity)	Maintain continuity of supply in relation to critical MoD programmes; maintain UK capabilities
16	*Voyis Imaging/assets belonging to the University of Southampton*	Military and dual use	Canada/UK	Due diligence checks on new customers and annual reporting of new customers to the government
17	*EDF Energy Holdings Ltd (via its wholly owned subsidiary, GEAST UK Ltd)/GE Oil & Gas Marine & Industrial UK Ltd and GE Steam Power Ltd*	Defence or military and dual use (naval propulsion)	France	Meet physical and information security requirements; implement governance arrangements to protect sensitive information; allow a government-appointed board observer to observe meetings; establish a steering committee to provide oversight of compliance; maintain capacity and capability; and provide step-in rights to the SoS as a measure of last resort

Notable prohibitions

Under the final order issued on 20 July 2022, the SoS – for the first time in the history of UK national security interventions – prohibited a proposed transaction outright. The transaction involved the acquisition of know-how relating to SCAMP-5 and SCAMP-7 vision sensing technology from Manchester University by Beijing Infinite Vision Technology Company Ltd, a Chinese commercial semiconductor company. The acquisition was blocked on the grounds that the technology could be used to build defence or technological capabilities, posing a significant national security risk to the United Kingdom.[88] A month later, the SoS issued another final order preventing Super Orange HK Holding Limited, a Hong Kong-based company, from acquiring Pulsic Limited, a UK-based rival active in developing electronic design automation software, which the SoS stated is used in the design of 'cutting-edge' integrated circuits that could have dual-use applications.[89]

The two orders to unwind previously completed transactions under the NSI Act are also of particular interest, given that these have both been appealed and will therefore be the test cases for judicial review processes in a national security context. The first of these transactions to be unwound by way of a final order issued on 16 November 2022 was an acquisition by Nexperia BV (which is owned by Chinese and Shanghai-listed tech company Wingtech) of the remaining 86 per cent of shares in Newport Wafer Fab (a semiconductor wafer manufacturing facility), taking its shareholding to 100 per cent. The SoS considered that a risk to national security relating to compound semiconductor activities at the Newport site, which could undermine UK capabilities as well as prevent other technological expertise in the so-called South Wales Cluster being engaged in future projects relevant to national security.[90] In a statement responding to the final order, Nexperia announced that it would appeal the decision via judicial review.[91]

The second of these transactions was unwound by way of a final order issued on 19 December 2022 and was an acquisition by L1T FM Holdings UK Limited (which is understood to have Russian links) of Upp Corporation Limited, a London-based telecommunications provider. The SoS's final order had the effect of requiring L1T to sell 100 per cent of Upp and for Upp to complete a security audit of the Upp network prior to the sale.[92] On 7 April 2023, it was reported that L1T had filed an application for judicial review of the final order.[93] In its statement confirming its appeal, L1T stated that it was not itself sanctioned and that it had taken steps to distance itself from the sanctioned shareholders, including by freezing their decision-making and oversight powers and stopping dividends.

In addition, three deals have been abandoned following formal national security interventions by the government under the previous EA02 regime. *Aerostar/Mettis* (2020) and *Gardner/Impcross* (2020) involved attempted acquisitions by Chinese-owned investors of UK aerospace manufacturers. *Shanghai Kington Technology/Perpetuus* (2022) involved the attempted acquisition by a Chinese tech company of a UK-based tech firm active in the functionalisation of graphene and other nanomaterials (including graphite), which have a range of strategic applications. At the time of intervention, interim orders preventing the integration of the merging parties were issued by the SoS in all three transactions. Furthermore, after the deals were abandoned, the acquirers were asked to provide additional assurances that the transaction would not proceed.[94] More recently, under the NSI regime, the proposed acquisition of Electricity North West, the power network operator for the North West of England, by Redrock Investment Limited was aborted shortly after the SoS issued a final order. Although these transactions were not formally blocked, considering the SoS's enforcement approach and the prevailing political climate, it is likely that the government's national security intervention was a key factor in the failure of the transactions.

Notable mitigations

A number of transactions have also been cleared following the parties agreeing to give remedies to allay the government's national security concerns. In *Epiris/Sepura* (2022), the UK-based private equity buyer was required to give assurances that sensitive information and technology held by the target – a supplier of digital radio systems used by emergency services in the United Kingdom – would be protected, and to maintain UK strategic capabilities that relied on the target's products and services supplied to the TETRA Airwave network and Emergency Services Network.[95] These were the first remedies imposed by the ISU under the NSI Act and replaced the EA02 national security undertakings provided by the seller, Hytera, for its acquisition of Sepura in 2017 (as amended in 2021).[96]

In *Parker-Hannifin/Meggitt* (2022), under the previous EA02 regime, Parker-Hannifin committed to honouring Meggitt's supply obligations to the MoD and to reinforce existing security arrangements to protect classified information, including retaining a majority of the board of directors of Meggitt as UK nationals resident in the United Kingdom. In addition, similar to *Cobham/Ultra* (see below), Parker-Hannifin agreed to institute a government-approved control plan to prevent US ITAR controls applying to Meggitt's products, technologies and services used by the MoD.

In *Cobham/Ultra* (2022), the government went even further and accepted a set of remedies that went beyond what has typically been required for acquisitions in the defence sector. Although Cobham is a UK-based defence company, it had been acquired by and was under the indirect control of Advent, a US private equity firm.[97] Thus, a key concern raised by the MoD was possible commercial or non-UK government influence over Ultra that could undermine UK's strategic capabilities. In addition to the commonly required safeguards around the target's strategic capabilities and sensitive information held within the target, the parties agreed to a stringent structural remedy that involved transferring those of Ultra's facilities that deliver sensitive capabilities to the government into two newly created legal entities, over which the government would have board representation, approval rights over the entities' articles of association and strategic objectives, step-in rights over their transfer of ownership and government access to intellectual property. The package of remedies also included – for the first time – additional commitments and control measures to prevent the US ITAR from applying to the target's sensitive assets, which were deemed critical to maintain UK sovereign control over strategic defence capabilities.

More recently under the NSI Act regime, in *EDF Energy Holdings Ltd/GE Oil & Gas Marine & Industrial UK Ltd and GE Steam Power Ltd* (2023), the government similarly imposed stringent requirements on the transaction, despite the acquirer originating from France and being part of the group that supplies and manages the United Kingdom's civil nuclear power installations. The government determined that the risk to national security arising from the naval propulsion systems supplied by the target companies was sufficient to require the parties to accept a government-appointed observer to observe meetings of certain boards and that, in circumstances where the final order was breached in a manner serious enough to jeopardise the fulfilment of critical MoD programmes, the SoS would have the power to step in and take operational control of or take over the relevant (part of the) business necessary for the fulfilment of those programmes, or both. In addition, safeguards around the target companies' strategic capabilities and capacity, governance and physical and information security were also required.

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

Within the existing sanctions regimes, there are no sectors in the United Kingdom in which foreign investment is generally prohibited.

ii Restricted sectors

There are no sectors in the United Kingdom that are specifically restricted for foreign investors.

As explained above, investments in certain sectors that meet the applicable thresholds are subject to mandatory screening under the NSI Act.

In addition, there are a limited number of UK companies in which the government holds a special share (known as a golden share), which has been put in place as part of the privatisation of national assets or stated-funded investments in strategically important sectors, such as defence or nuclear.[98] A special share typically gives the government the ability to veto future share transfers or certain clearly defined management decisions of the company. Several special shares also include powers over the disposal of material assets.[99] Some of the remedies imposed on the *Cobham/Ultra* and *EDF Energy Holdings Ltd/GE Oil & Gas Marine & Industrial UK Ltd and GE Steam Power Ltd* transactions (discussed above) come close to replicating these restrictions.

V TYPICAL TRANSACTIONAL STRUCTURES

There are generally no specific legal considerations facing foreign entities that seek to set up new facilities or businesses or to carry out mergers and acquisitions in the United Kingdom above and beyond the considerations that also apply to domestic investors.

VI OTHER STRATEGIC CONSIDERATIONS

As a foreign investor, there are various factors that could affect the risks and structuring of a contemplated transaction (in particular those factors that point to a heightened risk of national security review or political intervention). These include, for example:

- the transaction structure (i.e., share or asset purchase, as asset purchases do not lead to mandatory notifications but may still be called in);
- the identity of the target, in particular:
  - the sector, or sectors, in which it is active (e.g., defence, regulated or otherwise falling within one of the designated sectors under the NSI Act);
  - any government links that could trigger additional government review or consent requirements (e.g., special or golden shares, defence contracts or strategic government funding);
  - whether it is a public company subject to the Takeover Code (which governs the timing of takeovers, disclosure requirements and various obligations regarding documentation and announcements to shareholders of a target company, including the bidder's plans for the target company); and
  - where the target is based outside the United Kingdom, the extent to which it has links to the United Kingdom (e.g., by way of supply of goods and services to or activities carried on in the United Kingdom, which may bring the transaction within the scope of, or elevate the risk of, a national security review);
- the level of ownership or control acquired (which can affect the relevant statutory regimes that apply and the likelihood of intervention);
- characteristics of the investor itself that could elevate national security risks (e.g., existing activities within or relating to the target sector, any links to national governments or state entities and the track record of investments); and
- likely political or public perception (which is likely to involve a combination of acquirer identity, target profile and strategic drivers for the deal and how it will affect the United Kingdom).

When a transaction presents substantive risks of a national security review under the NSI Act, the key issues that should be considered at the outset include the following:

- the timing of the national security review and the effect on the overall deal timetable (including interactions with the timing of other antitrust or regulatory reviews);
- the effects of possible remedies on the buyer's future plans for the target or exit strategy (or any effects on the buyer's ability to offer antitrust remedies);
- contractual protections in transaction documentation (e.g., conditionality, risk allocation measures, long-stop date, cooperation from the seller or the target, national security warranties or indemnities); and
- disclosure requirements, which may involve requests for extensive information regarding the parties' activities and ownership structure, transaction rationale and potential confidentiality issues that could affect the buyer's ability to conduct due diligence on the target's most sensitive activities.

VII OUTLOOK

Notwithstanding recent developments, the UK government is keen to assure investors that the United Kingdom remains open for business and has set up both the Office of Investment (launched in November 2020) and the Investment Council (established in April 2021) to continue to encourage investment into the United Kingdom.[100]

Although still in its early stages, the NSI regime is so far living up to the government's promise that the system will provide a simplified process with predictable timing for investors while leaving the government with sufficient flexibility to stop transactions that it considers could harm national security. The government is also responding to stakeholder feedback to make the regime more transparent. In his foreword to the NSI Annual Report 2023, the SoS reiterated that:

> *The first full year has been extremely positive, but I am keen to keep communicating with businesses and to look at where/how the system can be improved. My Ministerial team, officials and I frequently run and attend engagement events, and we welcome your feedback wherever possible.*[101]

However, we can continue to expect a more interventionist approach towards certain types of investments, especially those that pose a higher risk to national security. In addition to the traditional military and defence sectors, there will be a growing focus on transactions that involve advanced or emerging technologies (including important UK R&D hubs), critical national infrastructure and the resilience of critical supply chains.[102] The broad scope of the regime, coupled with severe penalties for non-compliance, will also create additional filing requirements for a large number of transactions.

The current climate also suggests that foreign takeovers of sensitive UK assets or technology may become increasingly politicised. Heightened publicity and political sensitivity have already manifested in recent transactions and are likely to continue under the NSI Act (see, for example, *Nexperia/Newport Wafer Fab* and *Nvidia/ARM*, which underwent extensive public and political debate about whether the transactions should be allowed to proceed).

Following the United Kingdom's departure from the European Union, the CMA (the United Kingdom's competition authority) has already been seen to assert jurisdiction over global transactions that have limited connection to the United Kingdom. Similarly, the government's ability to intervene on national security grounds does not stop at UK borders; there are broad powers under the NSI Act for the government to freeze, block or impose conditions on transactions with only a limited nexus to the United Kingdom (and, unlike merger control review, there are no minimum requirements around a target's turnover or share of supply or market share in the United Kingdom). Although national security interventions in the United Kingdom so far have focused on UK-based targets, investors will need to be mindful of the consequences of breaching mandatory notification requirements under the NSI Act, as well as additional deal risks in sensitive sectors, even when the investment is taking place outside the United Kingdom.

Investors from friendly countries or non-strategic buyers (such as investment funds) are not immune from increased deal scrutiny under the NSI Act. A report by the Foreign Affairs Committee highlighted that the risks associated with the loss of strategic technologies to overseas actors extends to the United Kingdom's allies.[103] This is evident from the reviews of a number of recent acquisitions by investors based either in the United Kingdom or in traditionally allied states.

The NSI Annual Report 2023 also confirms this with respect to the 2022–2023 financial year, with the percentage of call-ins by associated origin of investment being *32 per cent* for the United Kingdom, 20 per cent for the United States and 14 per cent for Canada – the three most called-in countries of origins with the exception of China (42 per cent) (noting that deals can be associated with more than one country).[104] Nevertheless, the government's position, restated by the NSI regime's current SoS, Oliver Dowden MP, is that 'China represents the largest state-based threat to economic security.'[105] The government is keen to emphasise that this does not mean 'decoupling' the United Kingdom from China's economy, but it should be seen as de-risking that engagement. Investors with links to China in particular, whether they are in a consortium or acting alone, should be alert to this heightened risk of intervention and plan for how that risk can be mitigated.

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Endnotes

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2 Cabinet Office , 'National Security and Investment Act 2021: Annual Report 2022-2023, 1 April 2022 – 31 March 2023' (Cabinet Office, NSI Annual Report 2023).
3 ibid.
4 See BEIS, National Security and Investment Bill: Impact Assessment (IA) (9 November 2020), p. 22. Note that the estimate was provided in relation to an earlier iteration of the NSI Act, which included an additional 15 per cent notification threshold (pursuant to which the IA estimated that around 5 per cent of notifications would be subject to in-depth assessment and 1 per cent requiring remedies).
5 *Financial Times*, 'UK pledges greater transparency of how it scrutinises deals' (3 April 2023).
6 We note, however, that unlike the previous regime for national security interventions (as discussed below), the government is not required to publish the fact that it has called in a transaction for in-depth review, but only when it has published a final order that imposes remedies or has ordered a transaction to be blocked or unwound.
7 BEIS, NSI Annual Report 2022.
8 Enterprise Act 2002 (EA02), Section 58.
9 In particular, communications; water, electricity, gas and energy supply; oil, gas and carbon storage; nuclear; and aviation (regulated by Ofcom, Ofwat, Ofgem, the North Sea Transition Authority, the Office for Nuclear Regulation and the Civil Aviation Authority, respectively), as well as financial services, payment systems, rail and gambling (regulated by the Financial Conduct Authority/Prudential Regulatory Authority, Payment Systems Regulator, Office of Rail and Road and Gambling Commission, respectively).
10 Post-offer undertakings were introduced in 2015 and are governed by Rule 19.5 of the United Kingdom's City Code on Takeovers and Mergers (the Takeover Code), which is regulated by the Takeover Panel.
11 In *Cobham/Ultra*, in addition to the national security remedies agreed under the EA02, Cobham also entered into a deed with the government committing to maintain the corporate headquarters of the target in the United Kingdom, increase engineering research and development (R&D) expenditure, establish a scholarship fund and increase the number of apprentices employed by the target.
12 In *Parker-Hannifin/Meggitt*, in addition to the national security and competition remedies agreed under the EA02, Parker-Hannifin entered into a separate deed of covenant with BEIS providing a range of economic undertakings, including in relation to use of the target's brand, maintaining the target's headquarters and core operational capabilities in the United Kingdom, guaranteeing existing government supply contracts and industrial engagements, as well as committing to minimum levels of technical employees and apprenticeships, R&D expenditure and sustainability targets.
13 In *Viasat/Inmarsat,* the acquirer agreed a package of legally binding economic undertakings with the government, which included certain 'national security-like' undertakings, such as committing to UK ownership of Inmarsat's satellite fleet, approval rights over key strategic decisions for the target group by a UK board of directors, and to leverage the UK supply chain, particularly for delivery of national critical infrastructure – see Viasat press release dated 21 March 2022, available at https://investors.viasat.com/news-releases/news-release-details/viasat-inmarsat-reach-agreement-uk-government-plan-increase.
14 The average number of transactions called in on national security grounds under the previous EA02 regime increased from one every two years (between 2004 and 2018) to three call-ins per year (2019–2021).
15 Cabinet Office, NSI Annual Report 2023.
16 ibid.
17 The *Nvidia/ARM* transaction was subsequently abandoned, apparently because of competition concerns raised by competition authorities in various jurisdictions. However, this did not preclude the SoS raising detailed concerns regarding the security and competitiveness of ARM's intellectual property under Nvidia's ownership, including concerns around the exposure to parallel regulatory processes in other jurisdictions (see Competition and Markets Authority (CMA), Issues Statement (20 December 2021), Paragraph 52, available at https://assets.publishing.service.gov.uk/media/61c0708f8fa8f5037cc5e2a9/NVIDIA_ARM_P2_Issues_Statement_-.pdf).
18 The national security referral may be explained by the parallel conclusion that there were also competition issues that merited a Phase II investigation.
19 See scheme circular posted by Softbank for the takeover of ARM, dated 3 August 2016, which included a set of legally binding 'post-offer undertakings' to maintain ARM's UK headquarters and employee headcount and voluntary intention statements regarding its future plans for ARM's management, employees and strategic plans.
20 See Section III.vi, 'Prohibitions and mitigations', below.
21 See ISU Notice of Final Order under the NSI Act in relation to the acquisition of Sepura Ltd by Epiris LLP (14 July 2022).
22 See Section III.vi, 'Prohibition and mitigation', below.
23 See ISU Notice of Final Order under the NSI Act in relation to the acquisition of GE Oil & Gas Marine & Industrial UK Ltd and GE Steam Power Ltd by EDF Energy Holdings Ltd via its wholly owned subsidiary GEAST UK Ltd (7 August 2023).
24 See ISU Notice of Final Order and ISU Notice of Revocation under the NSI Act in relation to the acquisition of Electricity North West Limited by Redrock Investment Limited (29 September 2022 and 20 December 2022).
25 Cabinet Office, NSI Annual Report 2023.
26 ibid.
27 *Bloomberg*, 'U.K. Probes WindAcre's Nielsen Stake Under New Takeover Law' (22 April 2022).
28 See BEIS press releases, 'BT acquisition called-in for national security assessment' (26 May 2022) and 'Government to take no further action under National Security and Investment Act on BT share acquisition' (23 August 2022).

29 ISU Guidance, 'National Security and Investment: Market Guidance April 2023' (27 April 2023).
30 Cabinet Office, NSI Annual Report 2023.
31 See UK Parliament, 'BEIS Sub-Committee on National Security and Investment' available at https://committees.parliament.uk/committee/631/beis-subcommittee-on-national-security-and-investment/.
32 See UK Parliament, 'Memorandum of Understanding on scrutiny of the Investment Security Unit' available at https://publications.parliament.uk/pa/cm5803/cmselect/cmbeis/1235/report.html.
33 Cabinet Office, NSI Annual Report 2023.
34 To date, the NSI Act is accompanied by four pieces of secondary legislation: National Security and Investment Act 2021 (Notifiable Acquisition) (Specification of Qualifying Entities) Regulations 2021; National Security and Investment Act 2021 (Prescribed Form and Content of Notices and Validation Applications) Regulations 2021; National Security and Investment Act 2021 (Monetary Penalties) (Turnover of a Business) Regulations 2021; and National Security and Investment Act 2021 (Procedure for Service) Regulations 2021.
35 See BEIS Notice, 'MoU between BEIS and the CMA on the operation of the National Security and Investment Act 2021' (16 June 2022), and NSI Act, Section 31(2).
36 NSI Act, Section 62(4).
37 ISU Guidance, 'The National Security and Investment Act alongside regulatory requirements' (updated 19 June 2023).
38 NSI Act, Section 7(2).
39 ibid., Section 7(3).
40 ibid., Section 7, Paragraphs (4) and (5).
41 ibid., Section 7(6).
42 ISU Guidance, 'National Security and Investment Act: details of the 17 types of notifiable acquisitions' (updated 27 April 2023).
43 NSI Act, Section 8.
44 ibid., Section 6(6).
45 ibid., Section 6, Paragraphs (5) and (6).
46 ibid., Section 13(1).
47 ibid., Sections 2(3).
48 ibid., Section 8(8).
49 See ISU Guidance, 'Check if you need to tell the government about an acquisition that could harm the UK's national security' (updated 31 May 2023): 'Any assessment by the government of an acquisition of material influence under the NSI Act will be considered in the light of the relevant section on material influence in the CMA guidance but applying the concept in the context of the NSI Act, so far as is appropriate.' For the relevant CMA guidance, refer to CMA, 'Mergers: Guidance on the CMA's jurisdiction and procedure' (as amended 4 January 2022), Paragraph 4.17 et seq.
50 In its past decisional practice, the CMA has only rarely found shareholdings of less than 15 per cent to confer material influence on the acquirer.
51 NSI Act, Section 9(1).
52 ibid., Section 2(2).
53 ibid., Section 2(4).
54 ISU Guidance, 'National Security and Investment Act 2021: Statement for the purposes of section 3' (2 November 2021): 'The government intentionally does not set out the exhaustive circumstances in which national security is, or may be, considered at risk. This is longstanding policy to ensure that national security powers are sufficiently flexible to protect the nation. Therefore nothing in this statement should be interpreted as a definition of national security.'
55 ibid.
56 ISU Guidance, 'National Security and Investment Act: market guidance notes July 2022' (19 July 2022) and 'National Security and Investment: Market Guidance April 2023' (27 April 2023).
57 NSI Act, Section 2(1).
58 ISU Guidance, 'National Security and Investment Act: details of the 17 types of notifiable acquisitions' (updated 27 April 2023).
59 Cabinet Office, NSI Annual Report 2023.
60 NSI Act, Section 14(1).
61 ibid., Section 41(1).
62 ibid., Sections 39 and 41.
63 ibid., Sections 15 and 16.
64 Cabinet Office, NSI Annual Report 2023.
65 NSI Act, Section 18(2).
66 ibid., Sections 14(5) and 18(5).
67 Cabinet Office, NSI Annual Report 2023.
68 NSI Act, Sections 14(9) and 18(9).
69 ibid., Sections 23(4) and 23(5).
70 ibid., Sections 23(6) and 23(9).
71 ibid., Section 24(4).
72 Cabinet Office, NSI Annual Report 2023.
73 NSI Act, Sections 14(6)(c) and 18(6)(c).
74 Cabinet Office, NSI Annual Report 2023.
75 ISU Guidance, 'National Security and Investment Act: market guidance notes July 2022' (19 July 2022) and 'National Security and Investment: Market Guidance April 2023' (27 April 2023).
76 NSI Act, Section 41, Paragraphs (3) and (4).

77 ibid., Section 39(2).
78 ibid., Sections 25(1) and 25(2).
79 *Financial Times*, 'Buyers challenge UK government's decision to block Truphone deal' (10 July 2022).
80 See the Public Interest Merger Reference (Gardner Aerospace Holdings Ltd and Impcross Ltd) (Pre-emptive Action) Order 2019 (SI 2019/1490) and the Public Interest Merger Reference (Mettis Aerospace Ltd) (Pre-emptive Action) Order 2019 (SI 2019/1515), discussed further in Section III.vi, 'Prohibition and mitigation', below.
81 Undertakings designed to prevent the US ITAR from applying to the target's activities were imposed for the first time in *Parker-Hannifin/Meggitt* and *Cobham/Ultra*, both in July 2022 (as published on BEIS's website). See also Section III.vi, 'Prohibition and mitigation', below.
82 NSI Act, Section 41(1).
83 ibid., Sections 39 and 41.
84 ibid., Section 41(2).
85 Cabinet Office, NSI Annual Report 2023.
86 NSI Act, Section 50.
87 ibid., Section 49(4).
88 See ISU Notice of Final Order under the NSI Act in relation to the acquisition of know-how related to SCAMP-5 and SCAMP-7 vision sensing technology (20 July 2022).
89 See ISU Notice of Final Order under the NSI Act in relation to the acquisition of Pulsic Ltd by Super Orange HK Holding Ltd (17 August 2022).
90 See ISU Notice of Final Order under the NSI Act in relation to the acquisition of Newport Wafer Fab by Nexperia BV (16 November 2022).
91 See 'Nexperia is shocked by the Secretary of State's order to divest Newport Wafer Fab', 16 November 2022 available at https://www.nexperia.com/about/news-events/press-releases/Nexperia-is-shocked-by-the-Secretary-of-State-s-order-to-divest-Newport-Wafer-Fab.html.
92 See ISU Notice of Final Order under the NSI Act in relation to the acquisition of Upp Corporation Ltd by L1T FM Holdings UK Ltd (19 December 2022).
93 *Financial Times*, 'LetterOne challenges UK national security sale of broadband provider Upp' (7 April 2023).
94 See BEIS, 'Proposed acquisition of Mettis Aerospace Limited by Aerostar: CMA report' (13 February 2020), Paragraph 2.10; see also the EA02 undertakings given to the SoS by Gardner Aerospace Holdings Limited in relation to its anticipated acquisition of Impcross Limited (23 July 2020), and 'Notice of cancellation of inquiry under section 48(1) of the Enterprise Act 2022' (26 May 2022) in relation to the anticipated acquisition by Shanghai Kington Technology Limited and others of the Perpetuus Group, Paragraph 3, both available on the CMA's website.
95 See ISU Notice of Final Order under the NSI Act in relation to the acquisition of Sepura Ltd by Epiris LLP (14 July 2022).
96 See revised EA02 Undertakings given to the SoS by Hytera Communications Corporation Limited in relation to Sepura plc (3 December 2021).
97 *Connect Bidco/Inmarsat* (2019) and *Advent/Blackstone/Cobham* (2019) were the first two UK national security cases that involved private equity buyers. In *Connect Bidco/Inmarsat* (2019), the SoS considered the investment structure and control rights and ultimately required undertakings that restricted information and management rights of the limited partners and co-investors pertaining to the target business. Similarly, in *Advent/Blackstone/Cobham* (2019), the review involved an examination of the ownership structure and concerns that insufficient security controls within the new ownership structure could result in unauthorised access to sensitive defence and security data held by Cobham or carried on Cobham's systems. Other recent national security interventions, including *WindAcre/Nielson* (2022) and *Epiris/Sepura* (2022), also involved private equity investors.
98 Examples include Rolls-Royce, BAE Systems and Qinetiq, in which the government retained a golden share following their sale to the public. More recently, the government has put in place special share arrangements to protect strategically important investments from unwanted takeovers, including Oneweb and two nuclear projects (Hinkley C and Sizewell C). The government has also recently announced its intention to reserve special shares in future government-funded nuclear projects: see https://twitter.com/ kwasikwarteng/status/1537063796233195520?lang=en-GB.
99 See, for example, the rights attached to the government's special share in Post Office Limited: BEIS, Post Office Limited: Shareholder Relationship Framework Document (25 March 2020).
100 Department for International Trade, Press release (27 April 2021), available at https://www.gov.uk/government/news/new-expert-council-formed-to-maximise-uk-investment-offer.
101 Cabinet Office, NSI Annual Report 2023.
102 See, for example, the strategic priorities laid out in the government policy paper 'Global Britain in a Competitive Age: The Integrated Review of Security, Defence, Development and Foreign Policy (CP 403) (updated 2 July 2021) and, more recently, 'Integrated Review Refresh 2023: Responding to a more contested and volatile world' (CP 811) (updated 16 March 2023). In addition to scrutinising investments, the government has moved forward with a number of initiatives designed to address vulnerabilities in critical infrastructure and supply chains, for example, (1) measures to protect against fuel supply disruptions, including new powers for the North Sea Transition Authority to identify and prevent an undesirable change of control in oil, gas and carbon storage infrastructure (see proposed Energy Security Bill, introduced to Parliament on 6 July 2022); (2) measures to enhance the security of digital supply chains and third-party information technology services (see consultation on proposals for legislation to improve the UK's cyber-resilience by the Department for Digital, Culture, Media and Sport, 19 January 2022); (3) the new Telecommunications (Security) Act, which gives the government powers to adopt regulations and issue codes of practice to boost the security standards in UK telecommunications networks (see latest proposals for consultation by Department for Digital, Culture, Media and Sport, 1 March 2022); (4) the establishment of the Research Collaboration Advice Team within BEIS to offer researchers advice on how to protect their work from hostile activity,

particularly in relation to cybersecurity, export controls and protection of intellectual property; and (5) potential new legislation to block listings on the London Stock Exchange on national security grounds (responses to the government's consultations were published on 31 December 2021).

103 House of Commons Foreign Affairs Committee, Sixth Report of Session 2019–21, 'Striking the balance: Protecting national security through foreign investment legislation' (HC 296) (19 January 2021), p. 7.

104 Cabinet Office, NSI Annual Report 2023. Note that acquirers can be associated with more than one country of origin of investment and acquisitions can have more than one acquirer, so one acquisition may be counted to two or more origins of investment – meaning that these percentages add up to more than 100 per cent.

105 BBC News, 'China top threat to UK economic security – Dowden' (11 July 2023).

Chapter 25

United States

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Summary

I OVERVIEW

The United States has long favoured foreign investment and, historically, the US government has imposed few restrictions on foreign investment inflows.[2] Scepticism about investment from China continues to be a notable – and bipartisan – exception to this general policy of openness to foreign investment.[3] Foreign investment, however, is subject to review and remedial action on national security grounds by the Committee on Foreign Investment in the United States (CFIUS or the Committee). CFIUS's most recent piece of authorising legislation is the Foreign Investment Risk Review Modernisation Act of 2018 (FIRRMA). While notifying a transaction to CFIUS remains voluntary in most circumstances, FIRRMA created mandatory filing requirements for transactions involving certain types of US businesses and foreign investors. In addition to this general national security screening regime, the United States has some sector-specific limitations and review procedures that govern foreign investment in regulated industries.

II YEAR IN REVIEW

We highlight three important developments in the past year in this section. First, the Biden administration issued an Executive Order that endorsed and amplified CFIUS's national security risk policies. Second, CFIUS put investors on notice that it intends to start using its penalty authority more aggressively by issuing its first ever CFIUS Enforcement and Penalty Guidelines. Third, CFIUS clarified that 'springing rights' that vest only after CFIUS completes its review cannot be used as a workaround to the 30-day waiting period for mandatory filings.

i Biden administration confirms economic security is national security

CFIUS has broad discretion as to what constitutes a national security risk, and its review of transactions reflects broader US government policies with respect to national security risks posed by foreign investment. On 15 September 2022, President Biden signed Executive Order 14083 (the EO) directing CFIUS to take certain national security risk factors into consideration when analysing transactions.[4] The EO did not change CFIUS's process or jurisdiction; rather, it reflects a formalisation in the CFIUS context of a broader US national security policy focus on economic security as a key driver of national security. The EO directs the Committee to consider risks to US technological leadership in specific areas and also makes clear that CFIUS has a role in addressing supply chain risks not only to the defence industrial base but also to areas that are important to economic security. It also instructs that transactions should be reviewed in the context of broader industry and investment trends to guard against longer-term risks to certain critical domestic capabilities. China is not mentioned by name in the EO, but, in a nod to CFIUS's persistent concern about China as a third-party threat in non-Chinese transactions, the phrase 'relevant third-party ties' appears 10 times. CFIUS was already factoring in these risks, but the EO effectively highlighted these considerations for transaction parties.

ii CFIUS issues enforcement and penalty guidelines

CFIUS can impose penalties for (1) failure to make a mandatory filing, (2) failure to comply with a CFIUS mitigation agreement and (3) making a material misstatement, omission or false certification to the Committee. Congress gave CFIUS the authority to impose penalties in 2008, but since then there have been only two publicly reported instances of CFIUS imposing penalties.[5] This paucity of publicly reported enforcement actions has led some to question whether CFIUS had sufficient enforcement resources[6] and motivated Congress to allocate money in FIRRMA to building out CFIUS's monitoring and enforcement capabilities. After several years of staffing up, on 10 October 2022, CFIUS issued its first ever Enforcement and Penalty Guidelines (the Guidelines).[7] The Guidelines reflect factors that are common sense and generally consistent with enforcement guidelines under other similar regulatory schemes (e.g., self-report violations, remediate where possible and never try to hide the ball, etc.). However, more notable than what the Guidelines say is what they portend. Having put the investment world on notice, CFIUS will very likely ramp up enforcement in the coming years. CFIUS officials have indicated that they have issued penalties over the past year that have not yet been publicly reported. They expect to periodically publish information about penalty actions that CFIUS has taken to impress upon investors that CFIUS compliance is not optional.

iii Springing rights are no longer a viable solution to mandatory filing timing challenges

If a filing is mandatory, CFIUS requires that it be submitted 30 days before the 'completion date' of the transaction. In instances involving minority investments, particularly where time is of the essence, investors have sometimes elected to separate their economic interest from governance rights, closing on the investment but delaying the grant of rights until after CFIUS clears the transaction (what is sometimes referred to as a springing rights structure). Previously, it was generally believed that this was consistent with the required 30-day waiting period for mandatory filing because the rights that would grant CFIUS jurisdiction in the first instance would not attach until after CFIUS had concluded its review (and might not attach at all if CFIUS elected to impose mitigation that, effectively, prevented the investor from holding such rights). However, CFIUS has posted an FAQ on its website making clear that the closing even on the economic interest is subject to a 30-day advance notification requirement, even if the governance rights are made contingent on CFIUS clearance.[8] This clarification has no impact on the use of springing rights in the context of a voluntary filing, which has no required waiting period.

III FOREIGN INVESTMENT REGIME

This section sets out the main details of the US national security review regime administered by CFIUS.

i Policy

US policy favours an open investment environment. Indeed, the 'sense of Congress' provision in CFIUS's authorising legislation states as follows:

> *foreign investment provides substantial economic benefits to the United States . . . [and] it should continue to be the policy of the United States to enthusiastically welcome and support foreign investment, consistent with the protection of national security.*[9]

With the exception of the Trump administration, successive US adminstrations have strongly endorsed the United States's traditional open investment policy.[10] While qualified by a reference to CFIUS reviewing transactions to ensure the protection of national security, President Biden pledged his 'administration's commitment to ensuring that the United States remains the most attractive place in the world for businesses to invest and grow'.[11]

The restrictions that the United States has imposed on foreign investment have been tailored to achieve primarily non-economic policy objectives, generally relating to national security. Significantly, the US foreign investment regime does not subject investments to an economic benefit test and, with limited exception, does not predicate jurisdiction on the national origin of the foreign investor. However, widely held policy concerns over US innovation, economic competitiveness and supply chain security have led to a blurring of the lines between the concepts of economic security and national security.[12] Thus, far from being an idiosyncratic quirk of the Trump administration, the view that 'economic security is national security' appears to be both enduring and bipartisan.

ii Laws and regulations

The US national security review process for foreign investment is governed by Section 721 of the Defense Production Act and is generally referred to as 'the CFIUS process' after the interagency body that administers it. CFIUS is composed of nine voting members:

Treasury (its chair), the White House's Office of Science and Technology Policy, the US Trade Representative and the Departments of Commerce (Commerce), Defense, Energy, Homeland Security, Justice and State. The Department of Labor and the Office of the Director of National Intelligence are *ex officio* non-voting members. Other executive branch agencies may be temporarily added as voting members on a case-by-case basis (e.g., the US Department of Agriculture might be added in an agribusiness transaction).[13]

Transaction parties will interact mostly with Treasury before and during a review, as Treasury manages the overall process, maintains the web portal that parties use to submit filing documents (the Case Management System or (CMS)) and communicates CFIUS's findings and decisions to the transaction parties on behalf of CFIUS. However, the lead agencies (namely, those with the strongest equities) will co-lead on substance, including negotiation of mitigation terms if warranted.

iii Scope

CFIUS reviews foreign investment in the United States for risks to national security. Its authorising legislation provides examples of national security issues that CFIUS may consider, but it does not provide a statutory definition of national security except to clarify that it includes homeland security and critical infrastructure.[14] CFIUS has the authority to review three types of transactions (collectively referred to as 'covered transactions'):

- covered control transactions;
- covered investments; and
- covered real estate transactions.

Pure greenfield investments are excluded from CFIUS's jurisdiction. In foreign-to-foreign transactions, CFIUS can assert jurisdiction over any US businesses involved in the transaction, but its ability to require mitigation remedies or recommend prohibition will be limited, at least practically, to US businesses.

A key concept for understanding CFIUS's jurisdiction is the definition of a technology, infrastructure or data (TID) US business. Under CFIUS's regulations, a TID US business is one that:

- produces, designs, tests, manufactures, fabricates or develops one or more critical technologies;
- performs certain functions relating to critical infrastructure products or services; or
- maintains or collects, directly or indirectly, sensitive personal data (SPD) of US citizens.[15]

Critical technology is defined as any technology that is controlled for export under specified provisions of law and regulation or designated by Commerce as an emerging or foundational technology.[16] CFIUS defines critical infrastructure through reference to specific functions relating to enumerated categories of products and services that are so vital that their incapacity or destruction would have a debilitating impact on national security.[17]

SPD is any:

- identifiable data maintained or collected by a US business that (1) targets or tailors products or services to any executive branch agency or military department with intelligence, national security or homeland security responsibilities or (2) has maintained or collected, or has a demonstrated business purpose to collect, specified types of data from more than one million individuals; or
- genetic data.[18]

iv Covered control transaction

A covered control transaction is any transaction that results in a foreign person obtaining direct or indirect control over a US business. CFIUS eschews bright line definitions of control, instead defining it as:

> *the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity . . . to determine, direct, or decide important matters affecting an entity.*[19]

Consequently, CFIUS may find that a minority shareholder has 'control' if it possesses certain negative rights (e.g., the ability to veto board decisions). Control jurisdiction is not dependent on the industry or other characteristics of the US business, only that the transaction results in foreign control of the US business.

v Covered investments

A covered investment is a non-controlling direct or indirect investment by a foreign person, other than an excepted investor,[20] in an unaffiliated TID US business that affords the foreign person:

- access to any material non-public technical information;
- board membership or observer rights; or
- any involvement, other than through voting of shares, in substantive decision-making of the TID US business regarding its critical technology, critical infrastructure products and services, or SPD.[21]

Thus, whereas control jurisdiction is not dependent on the nature of the US business, covered investment jurisdiction can apply only where the US business is a TID US business.

vi Covered real estate transactions

A covered real estate transaction is the purchase, lease or concession to a foreign party of 'covered real estate', whether proposed or completed. Covered real estate is as follows:

- real estate that 'is located within, or will function as part of, a covered port'; and
- real estate in close proximity to a US military installation or other property owned by the US government that 'is sensitive for reasons relating to national security'.[22]

For some installations, this latter proximity-based jurisdiction is triggered if the real estate is within one mile of the installation. In other instances, it is triggered if it is within 100 miles of the installation. Real estate within US census-designated 'urban clusters' and 'urban areas' is exempt from this proximity-based jurisdiction. Covered real estate transactions are distinguished from CFIUS's other two prongs of jurisdiction, in that the real estate need not constitute a US business to be covered. Thus, a greenfield business may not trigger covered control or covered investment jurisdiction, but it could trigger real estate jurisdiction.

In May 2023, Treasury proposed a rule that would add eight new military installations to Part 2 of Appendix A to 31 CFR Part 802, which contains the List of Military Installations and Other US Government Sites that can trigger CFIUS-covered real estate jurisdiction. This update was likely in response to controversy over CFIUS's determination that it did not have jurisdiction over the acquisition of land near Grand Forks Air Force Base in North Dakota by Chinese-owned Fufeng Group (Grand Forks Air Force Base is among the eight new facilities).[23]

vii Mandatory versus voluntary screening

Filing with CFIUS remains voluntary for most transactions. However, FIRRMA created two categories of mandatory filings (excepted investors, however, are not subject to mandatory filing requirements, see footnote 20). The first is a covered transaction, whether a covered control transaction or a covered investment, that results in the acquisition of a substantial interest in a TID US business by a foreign person in which the national or subnational governments of a single non-excepted foreign state have a substantial interest.[24] The second is a covered transaction – irrespective of government ownership – involving a TID US business that produces, designs, tests, manufactures, fabricates or develops one or more critical technologies for which a US regulatory authorisation (i.e., an export licence) would be required to export the subject critical technology to the foreign investors, including certain entities in the ownership chain.[25] Eligibility for any of three enumerated export licence exceptions, prior to consummating the transaction for items controlled under the Export Administration Regulations, provides an exemption to the critical technology mandatory regime.[26] Failure to make a mandatory filing can result in a fine up to the value of the transaction, with buyer, seller and target bearing liability.[27]

If a transaction is not subject to a mandatory filing requirement, the parties must decide whether to voluntarily notify the transaction to CFIUS. The carrot for filing voluntarily is that if CFIUS reviews and clears the transaction with 'no unresolved national security concerns', the transaction receives safe harbour and cannot be rereviewed by the CFIUS except under limited circumstances relating to misstatements or omissions or failure to comply with clearance conditions. The stick is CFIUS's indefinite authority to use its call-in powers to review any covered transaction that it has not cleared with safe harbour ('non-notified transactions') and take the full range of mitigating actions, including the recommendation that the President suspend or prohibit the transaction.[28]

The decision to file voluntarily is thus a matter of risk tolerance that is generally informed by whether CFIUS is likely to use its call-in powers and, if it does, whether it is likely to take remedial action that might threaten to undermine the parties' commercial objectives for the transaction. The likelihood of CFIUS using its call-in powers and taking remedial action is inextricably linked to how it understands and assesses national security risk. CFIUS analyses national security risk using three variables:

- threat is the intent and capability of a foreign person to take action to impair national security;
- vulnerability is the extent to which the nature of the US business presents susceptibility to impairment of national security; and
- consequence is the effect on national security that could reasonably result from exploitation of identified vulnerabilities by a threat actor.[29]

A threat does not require or imply a vulnerability, and vice versa. For example, a deal involving a non-threatening investor may pose a risk if the US business is a highly vulnerable supplier of a critical defence component, whereas a transaction involving an investor not seen as entirely trustworthy may pose little to no risk because the US business has no exploitable vulnerabilities.

Considerations other than national security risk sometimes also factor into transaction parties' decision to file, including:

- the size of a transaction and amount of publicity that it is likely to attract;
- whether the parties are making other regulatory filings with individual committee members that might result in the transaction being identified;
- eliminating the risk of a call-in of a large or particularly significant deal; and
- building or maintaining a positive reputation with CFIUS.

viii Procedures

There are two types of CFIUS filings: a long-form 'notice' and a short-form 'declaration'. Parties may elect either regardless of whether filing voluntarily or on a mandatory basis. The mandatory filing obligation is satisfied by the submission of a filing not later than 30 days before closing (see Section II for a discussion of how this 30-day period interacts with springing rights).

Both types of filing are submitted to CFIUS using Treasury's CMS web portal and, once in process, CFIUS has the authority to submit supplemental requests for information that must be answered, absent extension, within two business days for a declaration or three business days for a notice, with failure to submit the response by the regulatory deadline constituting grounds for rejection of the filing. CFIUS can also reject a filing if it identifies material misstatements or omissions during its review. Once submitted, parties may withdraw a filing only with CFIUS's permission. The type of filing has an impact on the timing of the review, the range of possible administrative outcomes and the filing fee assessed by CFIUS. Parties should consider the benefits and drawbacks of each type of filing in the context of the timing and complexity of the transaction.

In the case of a submission of either a notice or a declaration, if CFIUS determines that the transaction is not a covered transaction (i.e., it is not subject to CFIUS jurisdiction), CFIUS will inform the parties of this determination and terminate the process. If CFIUS determines that it does have jurisdiction and clears the transaction, the parties will receive safe harbour for the transaction as filed, though safe harbour would not necessarily cover future additional investments or changes in investor rights.

ix Notice

Parties are encouraged to submit a draft notice and engage in a pre-notification period prior to submission of a final notice. This is why this form is used most often for complex transactions. Once a notice is accepted as complete, a 45-day review period begins. At the end of this period, CFIUS must either issue a clearance letter or initiate the 45-day investigation. In 2022, slightly more than half of covered transactions that were filed as notices required investigation.[30] If CFIUS cannot conclude action by the end of the investigation period, by operation of law, the case enters a 15-day presidential review period within which the President must make a final decision.[31] A complete, properly filed notice results in one of three outcomes:

- CFIUS concludes action (with or without mitigation) and grants the transaction safe harbour;
- CFIUS makes a recommendation to the President to suspend or prohibit the transaction or otherwise seek a decision from the President, and the President (1) prohibits the transaction, (2) conditionally prohibits the transaction (e.g., prohibits the transaction if the parties do not reach an agreement with CFIUS that meets certain criteria) or (3) announces that he or she will not take action (which grants safe harbour to the transaction); or
- the parties withdraw their notice and abandon the transaction. If time is running out in the 45-day investigation period and the transaction parties need additional time to continue discussions with CFIUS (e.g., regarding mitigation remedies), the parties can seek CFIUS's permission to voluntarily withdraw and refile the transaction, which will restart the CFIUS clock.

Filing a notice is most likely to be beneficial for parties that need safe harbour to satisfy a contractual term or anticipate that a transaction will require mitigation. Additionally, if a transaction is particularly complex or the foreign investor is unfamiliar to CFIUS, a notice is generally more suitable than a declaration. A notice also requires a filing fee calculated based on the overall transaction value.[32]

x Declaration

Submitting a declaration initiates a 30-day assessment period, after which CFIUS can:

- request that the parties submit a full notice so that it can continue its review;
- issue a no-action letter informing the parties that it was unable to conclude action and that, while it is not requesting a full notice, it reserves the right to do so in the future;
- unilaterally initiate a review; or
- clear the transaction with safe harbour.

Declarations are generally more suitable for transactions where (1) the foreign investor is known to CFIUS and has a successful filing record and (2) the transaction is not overly complex in terms of either structure (e.g., one direct acquirer versus a multi-fund consortium), subject matter (e.g., an established technology versus an emerging technology) or national security considerations (e.g., few or no defence contracts).

There are three main benefits of filing a declaration. The first is timing. In addition to the shorter review timeline, declarations generally require less pre-filing coordination with CFIUS (e.g., no draft). Second, declarations generally require less information than a full notice. Finally, declarations do not incur a filing fee. The main risk of a declaration is CFIUS requesting a full notice at the end of its review, in which case the parties will have added an additional 30 days on to what might be a 90-day notice process. In the event of a no-action letter, transaction parties will have to determine whether they are comfortable closing with the possibility of CFIUS requesting a filing or whether they want to voluntarily file a notice to get the assurance of safe harbour.

xi Prohibition and mitigation

Negotiated mitigation agreements and imposed orders are CFIUS's primary tools for mitigating national security risks. In 2022, approximately 18 per cent of notices that CFIUS reviewed required mitigation measures.[33] CFIUS has broad discretion to implement whatever mitigation measures that it deems necessary, as long as they are supported by its risk-based analysis and do not duplicate the parties' obligations under otherwise already applicable law. Additionally, if CFIUS preliminarily identifies an ongoing risk to national security, it can impose an interim mitigation order that remains in effect until it concludes action, including through an order precluding closing pending completion of the CFIUS review.[34] Potential mitigation terms include, for example, limiting transfer of certain intellectual property, establishing guidelines relating to US customer information, providing that only US citizens will conduct certain activities, notifying customers of the change in ownership composition, erecting firewalls or other security protocols, or requiring divestiture of select assets or businesses.[35] In high-risk transactions that do not rise to the level of a prohibition, CFIUS may require passivity measures and limitations on governance, such as a proxy board. Violation of a CFIUS mitigation order or agreement can result in civil monetary penalties of up to the value of the transaction, damages or reopening of the review and imposition of further remedies.

If CFIUS identifies a risk requiring mitigation remedies, transaction parties should expect to receive a written communication from Treasury specifying the contours of measures that would resolve CFIUS's concerns. CFIUS may or may not provide insight into the specific nature of or basis for its concerns. CFIUS is generally willing to negotiate with parties over mitigation terms to ensure that the agreement will be effective over the long term and will not undermine the transaction. If CFIUS and the transaction parties are unable to reach a negotiated agreement, CFIUS can impose mitigation terms or recommend that the President suspend or prohibit the transaction.

Prohibiting or suspending a transaction is the sole, non-delegable authority of the President.[36] If CFIUS concludes that it is unable to mitigate a risk arising from a transaction, it will inform the transaction parties of its conclusion in writing and state that it is prepared to make a recommendation to the President. At this stage, many parties will request CFIUS's permission to withdraw and abandon the transaction rather than have it be sent to the President for a decision. The President's decision is publicly announced, whereas the government is otherwise generally prohibited from disclosing information about proceedings before CFIUS. To suspend or prohibit a transaction, the President must find credible evidence that a foreign interest might take action that threatens to impair the national security and that other laws do not, in the President's judgement, 'provide adequate and appropriate authority' to protect that national security.[37] Only seven transactions have been prohibited by presidential order, although many more have been withdrawn and abandoned in lieu of a prohibition.[38]

CFIUS has no administrative appeals process, and the President's findings and decision to suspend or prohibit a transaction are statutorily exempt from judicial review.[39] The US Court of Appeals for the District of Columbia has held, however, that the statutory bar on judicial review of the President's findings did not preclude a challenge on due process grounds.[40]

IV SECTOR-SPECIFIC REQUIREMENTS

i Prohibited sectors

Foreign investors generally are not prohibited from investing in any sectors of the US economy, although there are some sector-specific restrictions discussed below.

ii Restricted sectors

Separate from the CFIUS process, there are a few sector-specific regulatory regimes with oversight or restrictions on foreign investment. In many cases, these sectors also subject domestic investors to similar restrictions, for example requiring a licence to operate. Federal limitations and restrictions on foreign investment focus on sectors that involve public interest and public services.

iii Aviation

Foreign investment in the US airline industry is heavily restricted and is subject to control by the US Department of Transportation (DOT). There are domestic ownership requirements with respect to the issuance of aircraft registrations[41] and air carrier certificates of public convenience and necessity.[42] Overall foreign ownership of air carriers is capped at 25 per cent of the voting interests. Air carriers must also be under 'actual control' of US citizens.[43] Minority investments under the 25 per cent ownership limit are not allowed if actual control is with any foreign owner. When evaluating whether a corporation is under the actual control of US citizens, the DOT considers factors such as any foreign owner's involvement in management and business decisions and its influence and control over the board of directors.

iv Banking

The US banking industry is heavily regulated at both federal and state level.[44] Federal laws generally do not restrict foreign ownership or control of US banks, but the establishment or acquisition of a bank, branch, agency or commercial lending subsidiary in the United States by a foreign entity may be subject to review by federal or state regulators, including the Federal Reserve Board (FRB).[45] Furthermore, under the Bank Holding Company Act (BHCA),[46] FRB approval is also needed to operate as a bank holding company (BHC)[47] or to acquire more than 5 per cent of the voting securities of a US bank or BHC.[48] The FRB evaluates several factors when reviewing a foreign bank's application under the BHCA, including financial stability, competition, public convenience and whether the authorities in the foreign bank's home country exercise comprehensive consolidated supervision.[49]

v Communications

The Federal Communications Commission (FCC) is tasked with reviewing and authorising all radio and television broadcasting licences. The Telecommunications Act of 1996 restricts foreign governments and government representatives from holding various licences, including broadcast and common carrier licences.[50] Furthermore, foreign ownership of FCC licensees is capped in certain instances or may result in a licence being withheld or revoked (or both capped and withheld or revoked).[51] Team Telecom – formally known as the Committee for the Assessment of Foreign Participation in the United States Telecommunications Services Sector – provides input on the national security implications of foreign ownership and investment.[52]

vi Energy

Federal and state law heavily regulates energy resources in the United States. Under the federal Mineral Lands Leasing Act (and other laws), only US citizens and corporations organised under US law may obtain particular mineral, gas and oil leases, although there are exceptions if the investor's home country extends similar privileges to US citizens and companies.[53]

Under the Atomic Energy Act, a nuclear facility licence may not be acquired by an alien or corporation owned, controlled or dominated by an alien, foreign government or foreign corporation.[54] The Nuclear Regulatory Commission has issued guidelines for determining whether an alien, foreign government or foreign corporation owns, controls or dominates a licence applicant.[55] According to these guidelines, an applicant that is partially owned by a foreign entity may be eligible for a licence if it imposes certain conditions on the foreign investor, such as limiting nuclear material handling to US citizens.[56]

vii Shipping

Shipping between ports in the United States is limited to US-built, owned and registered vessels, with few exceptions.[57] Only statutorily eligible entities can obtain a registration from the US Coast Guard to engage in this activity,[58] and a registration generally is limited to US citizens or entities in which US citizens hold at least 75 per cent of the interests.[59]

V TYPICAL TRANSACTIONAL STRUCTURES

Briefly set out below are typical corporate structures and transactions pursuant to which a foreign investor may enter the US market. A series of state and federal laws govern investment of this kind. Generally, foreign investors are subject to the same corporate legal requirements and are required to follow the same corporate formalities as domestic investors.

i Choice of structure for new entities

Regulation on the formation, operation or dissolution of any structure is governed by state law, so foreign investors should be familiar with the laws of their respective jurisdictions. Foreign investors typically choose to incorporate in Delaware because its law is straightforward and well established. The choice of structure (e.g., corporation, partnership or limited liability company) is generally driven by tax and liability consequences and does not turn on whether the investor is foreign or domestic.

ii Acquisition of a majority or minority stake

Generally, there are no restrictions prohibiting a foreign investor from taking a majority or minority stake in, or acquiring 100 per cent of, a US private corporation or other legal entity, other than with respect to those entities operating in specific regulated sectors, as discussed in Section IV. Foreign investors need comply only with the laws that would be applicable to acquisitions by domestic investors (e.g., merger control laws).

iii Mergers

There are two primary methods of acquiring a company in the United States that are available to domestic and foreign investor alike: a stock acquisition directly from the stockholders or a merger. For public company acquisitions (and some private companies) where the stock is widely held by a disparate group of stockholders, an acquirer typically will use one of two methods: a tender offer followed by a squeeze-out merger (a 'two-step' process) or calling a stockholder vote to approve a merger (a 'one-step' process).

iv Asset acquisition

If an investor seeks to acquire certain or all the assets of a US target, in most cases, the law governing that acquisition generally will be the law of the contract and the law of the state in which the assets reside. Certain acquisitions of material assets, or all or substantially all a company's assets, may require stockholders' approval (and therefore be governed by the federal securities law and proxy rules) for certain public companies. No unique legal requirements govern the acquisition of assets by foreign investors and generally there are no restrictions on ownership by foreigners of US real property (except for certain restrictions on agricultural land and mineral lease rights).

VI OTHER STRATEGIC CONSIDERATIONS

US policy has been focused in the recent term on addressing the perceived threat presented by Chinese technological advancement. That policy consideration, in particular, has resulted in a government-wide approach to shoring up laws and aggressively using existing authorities to block Chinese access to US technology, markets and money, and to ween critical US supply chains off their reliance on Chinese inputs. This effort reached far beyond the US national security review process to include restrictions on Chinese company access to US capital markets and restrictions on deploying certain Chinese components in the United States, in particular in the telecommunications industry. However, this policy has had a number of implications for the national security review process as well. For example, CFIUS often scrutinises the national security risks that China can pose as a third-party threat actor in transactions that do not directly involve a Chinese company, that is by exploring the commercial links that the non-Chinese acquiring person has with China and the vulnerabilities to China. Indeed, as discussed in Section II, President Biden's CFIUS EO makes repeated reference to threat posed by transaction parties' 'relevant third-party ties'. As a result, not only has direct Chinese investment in the United States come under greater scrutiny but so also have the ties that companies have to China. Additionally, the US government has sought greater cooperation and convergence with certain allied governments on the common threats they face (including China) and how to use foreign investment screening tools effectively to address such threats. This has allowed CFIUS to effectively extend its authority by tapping into enforcement mechanisms outside its jurisdiction, for example by working with an allied nation that might have a greater equity, jurisdictional basis or enforcement mechanism.

VII OUTLOOK

The Biden administration has made clear that it intends to build out the US regulatory infrastructure to manage evolving national security risks and to maintain the US edge in technology. This will likely result in the continued blurring of the concepts of national security, economic security and supply chain security, as well as the attendant expansion of the number and variety of technologies and products that get swept up under the growing web of US investment security regulations. We expect this to manifest in three ways over the coming year.

First, strategic competition with China will continue to suffuse all aspects of investment security, particularly in regard to key technologies viewed as the essential building blocks of US technological (and thereby military and economic) competitiveness. The Biden administration's October 2022 National Security Strategy (NSS) identified geopolitical competition as one of the principal challenges that the United States faces, with China being 'the only competitor with both the intent to reshape the international order and, increasingly, the economic, diplomatic, military, and technological power to do it'. A key strategy to address the geopolitical challenge, according to the NSS, is to ensure that 'strategic competitors cannot exploit foundational American and allied technologies, know-how, or data to undermine American and allied security'.[60] President Biden's National Security Advisor, Jake Sullivan, identified these foundational technologies in a September 2022 speech. Three 'families of technologies', he argued, will be force multipliers, the 20 per cent of technologies that will determine 80 per cent of success: (1) computing-related technologies, including microelectronics, quantum information systems and artificial intelligence (AI); (2) biotechnologies and biomanufacturing; and (3) clean energy technologies. Foreign investors involved in these and other key technologies will have to be increasingly cognisant of their commercial footprint in China if they wish to continue investing largely unimpeded in the United States.[61]

Second, the drive to secure and strengthen US supply chains will intensify. For example, shortly after taking office, President Biden issued an Executive Order directing the assessment and steps to strengthen the resilience of supply chains relevant to ensuring US 'economic prosperity and national security', covering semiconductors, high-capacity batteries, critical minerals and pharmaceuticals and, more generally, supply chains for the defence industrial base, public health and biological preparedness industrial base, information and communications technology industrial base, energy sector industrial base, and for production of agricultural commodities and food products.[62]

The concept of supply chain security will also continue to grow to encompass a wider range of products and services. For example, within months of taking office, the Biden administration allowed a Trump-era rule giving Commerce the authority to block or impose conditions on certain information and communications technology or services (ICTS) transactions with so-defined foreign adversaries to go into effect (the ICTS Rule). On 16 June 2023, Commerce published a final rule, implementing President Biden's 2021 Executive Order on Protecting Americans' Sensitive Data from Foreign Adversaries and amending the ICTS Rule.[63] The amendments centre on definitions relating to 'connected software applications', which fall under the ICTS Rule and could be read as targeting apps such as TikTok and WeChat under the auspice of supply chain security. One reason both the Biden and Trump administrations may have seen it necessary to stretch the concept of supply chain security to include products that would not generally be considered to be part of national security-related supply chains, such as mobile apps, is that the United States lacks a comprehensive data protection regime (e.g., the General Data Protection Regulation), and the definition of supply chain is capacious enough that it can act as a sort of catchall for risks not addressed by existing authorities (e.g., CFIUS). The problem, of course, is that when everything is supply chain security, the concept begins to lose both meaning and focus. To wit, as at the time of writing this chapter, over two years after letting the ICTS Rule go into effect, Commerce still has not created a mechanism for companies to seek preclearance of covered ICTS transactions.[64]

Third, outbound investment restrictions are right around the corner. On 9 August 2023, President Biden issued Executive Order 14105, Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern (the Outbound Investment Order),[65] which prohibits investments by US persons in Chinese companies or Chinese-owned companies as defined that are involved with certain technologies, and creates a notification requirement for others, in either case without a case-by-case US government review. The Treasury Department published an advance notice of proposed rulemaking[66] to seek public comment on future regulations to operationalise the Outbound Investment Order. Sectors slated for prohibition include those involving leading-edge integrated circuit (IC) design and production, electronic design automation, manufacturing equipment and supercomputers. Transactions involving quantum information technology, such as quantum computers and components; quantum sensors for military, intelligence or mass surveillance purposes; and quantum networking and communication systems for secure communications are also slated for prohibition. It is contemplated that transactions involving AI products for military, intelligence or mass surveillance end uses will fall under the prohibition as well. Activities proposed for notification requirements include IC design and production that is not otherwise prohibited within the semiconductors and microelectronics sector and AI in products for cybersecurity applications, robot control, surreptitious listening and non-cooperative location tracking. The proposed regime would cover equity, convertible debt, greenfield, joint ventures, private equity and venture capital transactions. Investments in publicly traded securities, index or mutual funds and limited partnerships that meet certain criteria are proposed not to be covered. The proposed regulations would impose obligations on US persons (1) to ensure that their controlled foreign entities do not and (2) to avoid directing foreign persons to engage in transactions a US person would be prohibited from engaging in under the regulations. The requirements applicable to outbound investment will not become effective until the implementing regulations are finalised.

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Endnotes

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2 The Organisation for Economic Co-operation and Development (OECD) ranked the United States slightly above the OECD average in its Foreign Direct Investment Regulatory Restrictiveness Index. The Index measures four types of statutory restrictions on foreign direct investment: (1) foreign equity restrictions; (2) screening and prior approval requirements; (3) rules for key personnel; and (4) other restrictions on the operation of foreign enterprises. See OECD, Foreign Direct Investment Regulatory Restrictiveness Index, available at http://goingdigital.oecd.org/en/indicator/74.

3 According to a report by Ernst & Young, Chinese investment in the United States decreased from US$7.9 billion in 2021 to approximately US$6.2 billion in 2022, a fraction of its US$49 billion high water mark in 2016. See https://assets.ey.com/content/dam/ey-sites/ey-com/en_cn/topics/coin/ey-overview-of-china-outbound-investment-of-2022-bilingual.pdf. Investment from Russia has also historically received significant scrutiny from CFIUS, but the overall volume of investment from Russia has been significantly diminished on both an absolute and a relative basis in the face of sanctions imposed following Russia's invasion of Ukraine.

4 The full text of Executive Order 14083 is available at https://www.whitehouse.gov/briefing-room/presidential-actions/2022/09/15/executive-order-on-ensuring-robust-consideration-of-evolving-national-security-risks-by-the-committee-on-foreign-investment-in-the-united-states.

5 Note that FIRRMA added penalties for failure to make a mandatory filing.

6 See, e.g., Treasury Should Coordinate Assessments of Resources Needed to Address Increased Workload, GAO-18-249, Published: Feb 14, 2018. Publicly Released: Mar 16, 2018, available at https://www.gao.gov/products/gao-18-249.

7 The full text of the Guidelines is available at https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-enforcement-and-penalty-guidelines.

8 The full text of the FAQ is available at https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-frequently-asked-questions.

9 Public Law 115–232 (13 August 2018).

10 Statement on Congressional Action on Legislation To Reduce the National Security Risks Posed by Certain Types of Foreign Investment (27 June 2018), available at https://www.govinfo.gov/content/pkg/DCPD-201800459/pdf/DCPD-201800459.pdf.

11 Statement by President Joe Biden on the United States' Commitment to Open Investment (8 June 2021), available at https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/08/statement-by-president-joe-biden-on-the-united-states-commitment-to-open-investment/.

12 To wit, according to President Biden, 'the principle that economic security is national security . . . [is] gospel in 2021'. See Remarks by President Biden at United States Coast Guard Academy's 140th Commencement Exercises (19 May 2021), available at https://www.whitehouse.gov/briefing-room/statements-releases/2021/05/19/remarks-by-president-biden-at-united-states-coast-guard-academys-140th-commencement-exercises/.

13 50 USC App. 4565(k)(2) (2018).

14 50 USC App. 4565(f) (2018).

15 31 CFR Section 800.248 (2020).

16 The provisions of law and regulation include, among others, (1) the United States Munitions List (USML) set out in the International Traffic in Arms Regulations (ITAR) and (2) the Commerce Control List (CCL), items controlled for reasons other than anti-terrorism, set out in Supplement No. 1 to Part 774 of the Export Administration Regulations (EAR). id. at Section 800.215.

17 For example, owning or operating (function) any internet protocol network that has access to every other internet protocol network solely via settlement-free peering (product or service). id. at Section 800.214 and Appendix A.

18 The types of SPD are financial data, consumer report data, insurance data, non-public electronic communications of non-employees, geolocational data, biometric enrolment data, data used to process government identification cards or US government personnel security clearance data (other than that of employees). id. at Section 800.241.

19 id. at Section 800.208.

20 An 'excepted investor' is one from an 'excepted foreign state' as designated by Treasury. These currently are Australia, Canada, New Zealand and the United Kingdom. See 31 CFR Sections 800.218 and 800.219 (2020) and Department of the Treasury, CFIUS Excepted Foreign States, available at https://home. treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/ cfius-excepted-foreign-states.

21 31 CFR Section 800.211 (2020).

22 See Provisions Pertaining to Certain Investments by Foreign Persons Involving Real Estate in the United States, 85 Fed. Reg. 3158 (17 January 2020) (codified at 31 CFR Section 802). The CFIUS regulations specify the sensitive government facilities and the triggering distances. CFIUS offers an online mapping tool that parties can use to identify whether the subject real estate is near US government facilities. See CFIUS Part 802 Geographic Reference Tool, https://mtgis-portal.geo.census.gov/arcgis/apps/webappviewer/index.html?id=0bb1d5751d76498181b4b531987ce263.

23 For a copy of the letter CFIUS sent to Fufeng Group, see Stacie Van Dyke, Fufeng moving forward with corn milling plant in Grand Forks, Dec. 14, 2022, available at https://www.valleynewslive.com/2022/12/14/fufeng-moving-forward-with-corn-milling-plant-grand-forks/. The full list of facilities is available at https://www.ecfr.gov/current/title-31/subtitle-B/chapter-VIII/part-802#Appendix-A-to-Part-802.

24 The 'substantial interest' element of this prong requires that the foreign investor acquire a voting interest of at least 25 per cent and the foreign government own a voting interest of at least 49 per cent in the foreign investor. See 31 CFR Section 800.244.

25 id. at Section 800.401.

26 These licence exceptions are Technology and Software Unrestricted (TSU); Encryption Commodities, Software, and Technology (ENC); Strategic Trade Authorization (STA). See id. at Section 800.401.
27 50 USC App. 4565(h)(3) and (l)((6)(D) (2018).
28 31 CFR Section 800.301.
29 id. at Section 800.801.
30 See CFIUS Annual Report to Congress (2022), available at https://home.treasury.gov/system/files/206/CFIUS%20-%20Annual%20Report%20to%20Congress%20CY%202022_0.pdf.
31 CFIUS timelines are measured in calendar days.
32 CFIUS filing fees range from US$750 to US$300,000 depending on the overall size of the transaction. See https://home.treasury.gov/system/files/206/Fact-Sheet-for-Interim-Rule-on-CFIUS-Filing-Fees.pdf.
33 See CFIUS Annual Report 2022 supra note 30.
34 50 USC App. 4565(l)(3) (2018).
35 CFIUS Monitoring and Enforcement Guidance, at https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-monitoring-and-enforcement.
36 50 USC App. Section 4565(b)(1)(G).
37 50 USC Section 4565(d).
38 The seven presidential prohibitions are: (1) China National Aero-Technology and Export Corp's acquisition of Mamco Manufacturing Inc (a US aerospace parts manufacturer) (1990); (2) Ralls Corp's acquisition of a US wind farm operator (2012); (3) Fujian Grand Chip Investment Fund LP's attempted acquisition of the US business of German semiconductor manufacturer Aixtron SE (2016); (4) China Venture Capital Fund Corporation Limited's US affiliate Canyon Bridge Capital Investment Limited's proposed acquisition of US semiconductor manufacturer Lattice Semiconductor Corporation (2017); (5) Broadcom's proposed 2018 acquisition of US 5G provider Qualcomm was prohibited before Broadcom could re-domicile from Singapore to the United States; (6) Beijing Shiji Information Technology Co, Ltd's acquisition of StayNTouch, Inc, a Delaware company (2019); and (7) ByteDance Ltd's acquisition of Musical.ly (2020) (although the status of this presidential order remains unclear as at the time of writing).
39 50 USC App. Section 4565(e)(1).
40 *Ralls Corp. v. Comm. on Foreign Inv. in the U.S.*, 758 F.3d 296, 311 (D.C. Cir. 2014) (remanding Administrative Procedures Act claims against CFIUS for consideration in the first instance after finding that they were not moot).
41 49 USC Section 44102(a).
42 49 USC Section 40101(a)(2).
43 49 USC Section 40102(a)(15)(C).
44 Some states impose citizenship and residency requirements on state-chartered banks. In addition, the directors of national banks chartered at the federal level must be US citizens. 12 USC Section 72.
45 12 USC Section 3105(d).
46 12 USC Sections 1841–1852.
47 A BHC is an entity that controls one or more banks but does not itself engage in banking. BHCs exist in the United States because the United States limits the activities in which US banks can be involved; a BHC permits a US bank to be owned by a company that engages in activities in which the US bank is not permitted to engage.
48 12 USC Section 1842(a). Foreign companies that acquire an interest in a BHC or US bank under certain circumstances are exempt from these limitations (e.g., with respect to operations outside the United States, see 12 USC Section 1841(h)(2) and (3); 12 USC Section 1843(c)(9)). Other regulations are applicable to the merger of certain banking institutions not regulated under the BHCA.
49 12 USC Section 1842(c).
50 47 USC Section 310(a).
51 47 USC Section 310(b)(4). The FCC has clarified that it will approach each application involving foreign investment in the controlling US parents of broadcast licensees on a case-by-case basis. See Commission Policies and Procedures Under Section 310(b)(4) of the Communications Act, Foreign Investment in Broadcast Licensees, MB Docket Nos. 13–50, 'Declaratory Ruling', 28 FCC Rcg 16244 (2013), available at www.fcc.gov/document/fcc-clarifies-policy-foreign-investment-broadcast-licensees-0, paragraph 11.
52 See https://www.justice.gov/nsd/committee-assessment-foreign-participation-united-states-telecommunications-services-sector.
53 30 USC Section 181.
54 42 USC Section 2133(d).
55 Final Standard Review Plan on Foreign Control Ownership, Control or Domination, 64 Fed. Reg. 52,355 (28 September 1999), available at www.govinfo.gov/content/pkg/FR-1999-09-28/pdf/FR-1999-09-28.pdf.
56 id. at 52,358.
57 46 USC App. 883; 46 CFR Section 68.5.
58 46 USC Section 12103(a).
59 46 USC Section 50501.
60 The full text of the NSS is available at https://www.whitehouse.gov/wp-content/uploads/2022/10/Biden-Harris-Administrations-National-Security-Strategy-10.2022.pdf.
61 Remarks by National Security Advisor Jake Sullivan at the Special Competitive Studies Project Global Emerging Technologies Summit, September 16, 2022, available at https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/09/16/remarks-by-national-security-advisor-jake-sullivan-at-the-special-competitive-studies-project-global-emerging-technologies-summit/.
62 Executive Order 14017, America's Supply Chains, available at https://www.whitehouse.gov/briefing-room/presidential-actions/2021/02/24/executive-order-on-americas-supply-chains/.
63 The full text of the final rule is available at https://www.federalregister.gov/documents/2023/06/16/2023-12925/securing-the-information-and-communications-technology-and-services-supply-chain-connected-software.

64 Commerce published an advanced notice of proposed rulemaking requesting public comment on the proposed licensing regime on 29 March 2021, but publication of a subsequent notice of proposed rulemaking has been delayed. See Securing the Information and Communications Technology and Services Supply Chain: Licensing Procedures, March 29, 2023, available at https://www.federalregister.gov/documents/2021/03/29/2021-06529/securing-the-information-and-communications-technology-and-services-supply-chain-licensing.

65 See Executive Order 14105 of August 9, 2023, Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern, 88 Fed. Reg. 54967 (August 11, 2023).

66 Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern, 88 Fed. Reg. 54961 (August 14, 2023).