THE M&A JOURNAL

THE INDEPENDENT REPORT ON DEALS AND DEALMAKERS

VOLUME 21 NUMBER 8

JANUARY 2022

*The M&A Journal is published approximately every six weeks, with ten issues per volume. The sequence of issues is therefore tracked by volume and issue number, rather than by month.

Special Report from Freshfields

The Evolution of Biden's CFIUS

Where does the agency go next?

Aimen Mir, a Freshfields partner, is the author of the firm's third edition of *Foreign Investment Monitor*. Mr. Mir talks to *The M&A Journal* about the burgeoning power of the Committee on Foreign Investment in the U.S. From its quiet birth in 1988, CFIUS has become the world's leader in the regulation of cross-border M&A with dozens of countries creating their own version of this intergovernmental agency charged with protecting the U.S. from foreign investments that are deemed a threat to national security.

Aimen Mir
Partner, Freshfields

The following is adapted from the firm's website: Mr. Mir is a partner in the Washington-based antitrust, competition and trade practice and the global sanctions and trade practice. Mr. Mir joined Freshfields after serving in several leadership roles in CFIUS and the US Department of the Treasury. Most recently, he spent four years as deputy assistant secretary for investment security at the U.S. Department of the Treasury, serving as the senior-most career CFIUS official and implementing Treasury's role as the chair of CFIUS. Mr. Mir managed CFIUS review and resolution of over 1,000 transactions, with an aggregate value exceeding $1.3tn. He also served as the principal U.S. government liaison with partner governments on foreign investment review issues.

Mr. Mir played a leading role in shaping and negotiating the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), the most significant expansion of CFIUS's powers in 30 years. He also shaped key elements of the emerging and foundational technologies provisions of the Export Control Reform Act of 2018. Mr. Mir also previously served as counsel in the national security division of the US Department of Justice.

The M&A Journal: This is certainly an impressive report. (See page 5.) Could you describe what you think are the most important issues? It seems CFIUS can't stop growing.

Aimen Mir: That's right. I think CFIUS, now under expanded authority, has put into place the processes and the manpower that it needs to really carry out its expanded mission. We started to see that this past year. Final regulations are in place. They have substantially increased their human capital. The industry is now largely familiar with how the process is basically going to work under this new set of rules. If you take all that and add an active M&A market over the past months, the net result is that the committee is poised to have reviewed a materially larger number of transactions this year than in the past couple of years put together.

CFIUS →

CFIUS

continued

The committee's jurisdiction has been expanded and the changes we've seen alongside that include an increased focus on the monitoring of transactions and the monitoring and enforcement of mitigation agreements. There is a new office at the Treasury Department, for example, that's focused on monitoring and compliance. Other agencies that are members of CFIUS have also reinforced their capabilities to survey the market, to see what transactions are occurring, to identify those they think should have been filed, and identifying transactions that may not have been subject to a mandatory filing requirement but over which CFIUS may have jurisdiction and may have an interest in at least better understanding the transaction. If CFIUS finds that it has concerns, the committee can actually effectively force you into the process.

The M&A Journal: That is a serious development.

Mr. Mir: It certainly is and CFIUS has been very active in that regard in the past year as well. In addition to expanded jurisdiction, we're seeing more transactions that are potentially reviewable and you have a more active staff that is reaching out to transactions and pulling them in. At the other end of the process, for transactions that have gone through and have been ordered to put in place conditions or mitigation to address specific concerns of CFIUS, you have a more active and formalized process for monitoring those agreements and ensuring compliance.

The M&A Journal: That's fascinating. And then there is the EU and CFIUS' role in advising member countries on how to set up their own regulatory review processes and how those processes can function.

Mr. Mir: Right. So, even during my time on the committee, we were actively engaged with our European counterparts and with the European Commission itself to discuss foreign investment screening issues. In parallel with the number of countries starting to strengthen their own regimes, the European Commission adopted its own screening mechanism which went live and became effective about a year ago. Transactions that are occurring within the EU are referred into this screening mechanism so that they can receive input from other member states as well as from the European Commission. And that's in parallel, as I said, to individual countries at the national level feeling assured that their authority has been strengthened by EU regulation and that now feel free to expand and strengthen the scope of their own domestic screening mechanisms.

We've certainly seen an uptick in the activity level in a number of countries, including Germany, France, Italy, Spain, and others, where they're very active in reviewing transactions. The numbers also show that the European Commission itself, through its screening mechanism, has been active in reviewing transactions.

The U.K. has a new law that went into effect on January 4th. (The National Security and Investment Act). It's a very ambitious law and they're expecting a couple of thousand transactions to be affected every year. It's very broad. Many of those deals may not end up with an actual review, but for many there may well be some impact on the transaction. The U.K. will certainly be a key area of focus for many companies because of the scope of its laws and the fact that it's going to be brand new.

Among the EU countries, there are also complex questions of jurisdiction. Many of them define their jurisdiction by sector and have mandatory filings for transactions that fall within one or more of those economic sectors. There are a lot of transactions that are only potentially implicated which can meant that as a practical matter the process of figuring out whether you're in or out can mean that you're in and have to submit a government filing.

The M&A Journal: I understand that CFIUS works very closely with its foreign counterparts and has for a long time. So it means that for large, complex deals you may well have to take a global approach to find out if national security regulatory schemes across many countries could affect you transaction.

Mr. Mir: Exactly. At this point, I think it's going to be largely ad hoc and case-by-case but one can expect that over time governments will become a little bit more comfortable as they figure out how this will all work in practice. How will the various regulators protect confidentiality, for example? What types of transactions might benefit from transaction-specific information sharing? I think this will evolve over time, probably relatively slowly. I think in the interim, what we'll see is a lot more engagement at the policy level, discussions of trends and best practices and so on. We're already seeing convergence

in many areas on how governments think about these issues. We'll probably see an acceleration of that as a result of these exchanges.

The M&A Journal: What sparked all this national security concern across so many countries? Was China the catalyst or was this a gradually growing sense that we must protect our national security assets, a concern that has spread across the world?

Mr. Mir: I think it's based on several interrelated factors. One is certainly investment trends outside of China. Countries obviously are happy to sell into the Chinese market but when Chinese investment started targeting or started flowing into companies that were seen as significant either from the technological point of view, or where the technologies have potential military applications, or where the investment was going into companies that were seen as critical to economic security or industrial policy, then you started to see this confluence or crossover between national security interests and economic security concerns as well as straightforward protectionism. Every country came to this set of issues slightly differently.

Across the U.S. and the U.K. and Europe, as well as in some other jurisdictions, there is a consensus that these regulatory tools should be principally reserved for national security considerations. But obviously the notions of what constitutes "national security" have changed over time. That's partly because of the nature of China as a competitor, where the distinction between state-driven planning and commercial enterprise is perhaps softer than in most Western industrial nations.

You see these foreign investment laws looking at national security from a much broader perspective where it's not just about who's the acquirer, but it's also about the target of the acquisition. To what extent does the target involve a resource or a capability over which the host country should exercise some oversight or control? These regimes have the authority to look at foreign-to-foreign transactions, meaning that if a German company is buying another German company, but the target company has U.S. operations, what is otherwise a domestic transaction becomes a potentially complex reviewable transaction. The target may not only have operations in the U.S. countries where the target has a subsidiary will also claim jurisdiction. What's more, there may be no actual subsidiary, but just a collection of assets that are effectively a business.

In some cases, even where there are only contracts between acquiror and target, those contracts can bring the transaction under review. Even if you don't expect there to be any issue with the transaction, you have to figure out whether or not it triggers any mandatory filing requirements in other jurisdictions. Countries often have different jurisdictional rules. Those rules often are not based upon bright-line thresholds. For example, in merger control, turnover is a critical factor. The analysis is a bit more straightforward in most instances than it is in the foreign investment context where there may be no dollar or value threshold. There may be the question of whether the transaction fits within a particular sector. Then there are governance rights that could affect how the transaction is viewed by regulators. You may have to include this in the list of critical diligence requirements in a deal. There are no cookie-cutter deals. You have to apply a bespoke analysis, country by country.

All this is now a fact of doing business. Any cross-border deal can potentially involve national security regulation. Few companies have operations only in one country. CFIUS and its counterparts have fast become part of the deal planning flow and companies are adjusting. In some cases, this process has a material impact in terms of outcomes, in terms of structuring and so on. But it's probably still fair to say that in most transactions, while it may create additional process, it doesn't necessarily fundamentally change deal considerations.

The M&A Journal: It doesn't sound like this will be any kind of brake on M&A activity. It's going at such a speed, and everyone is so busy. When there is a new regulatory regime or its power increase, one often hears predictions that transactions will shrivel. But deals go on. Is that your experience?

Mr. Mir: Yes, as you say, deals go on. There are some here or there where the potential risk does have a material impact. I mean, it may raise execution risk for the parties. It may change how they structure the transaction. In an auction, it may change who a seller is likely to pick from amongst the bidders. Some deals may not proceed because after consideration of these factors, they may decide there's too much risk. But I think for the most part, it's not going to be determinative. It will be a long pull in some cases, and it may well extend timelines. But more often in those transactions, there are other regulatory considerations that may also have longer timelines.

CFIUS ➔

CFIUS

continued

The M&A Journal: It doesn't seem that this is a new approach by a new administration, the way some practitioners view the antitrust changes both in personnel and in approach. But here, is it the case that this is just a natural evolution of an agency or a committee that sees its job as important and just keeps working?

Mr. Mir: Yes. I think there is a lot more continuity, certainly, in the foreign investment space than in mergers in the antitrust space. During the Obama administration there was an evolution in approach and by the beginning of the Trump administration, there was relative consensus within Washington, between Democrats and Republicans, over the risks related to foreign investments, in particular investment from China, which is why the 2018 legislation passed with virtual unanimous support from both sides of the aisle.

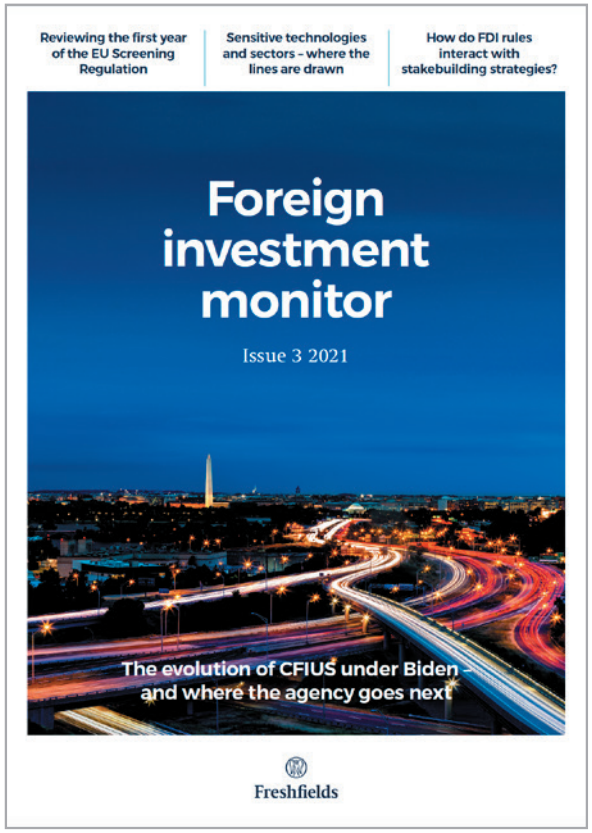
Obviously with the Trump administration, that shift accelerated but I think as it relates to perceptions of China, as it relates to perceptions of a need to protect critical capabilities, I think there is quite a bit of continuity. In part, this is because at the career staff level there's been continuity and a consensus for a long time on these issues. So political level consensus got to the point where it aligned with career staff-level views. Even as we approach 2022 with this administration, some key positions that are relevant to CFIUS have yet to be filled but there is continuity of staff. We haven't seen a whole lot of change and I don't expect to see the types of directional change that we're seeing in antitrust.

The M&A Journal: What effect has the pandemic had on global national security regulation?

Mr. Mir: The past couple of years with COVID has had an impact that in many ways is separate from such issues as China and Chinese investment. COVID caused a global recognition that it's important for countries to have security of supply for critical inputs. It started out initially with PPE and then medical supplies and vaccines, and now you're getting to semiconductors. Quite a progression. COVID has had significant implications across the economy that in many ways go to very basic notions of economic security. The pandemic has brought on a greater willingness to view economic security essentially as indistinguishable from national security.

~~MA~~

"As Adam Smith so aptly put it..."



The following text is reprinted with permission from Freshfields

Welcome to the third edition of Foreign investment monitor

First, our team in Washington analyzes the evolution of the Committee on Foreign Investment in the United States (CFIUS) under the Biden administration. Since entering the White House, the president has continued his predecessor's assertive approach to China, while CFIUS's work to strengthen its bench and improve its processes has boosted its ability to identify and investigate deals regardless of their origins. Looking ahead, it's possible CFIUS will receive the power to review non-controlling investments in a broader range of sensitive technologies – and it's even possible the government may gain the ability to scrutinize US outbound investments into China as it doubles down on the security risks of domestic businesses with strong ties to the PRC.

Next up we review the European Commission's first annual report into the impact of the EU's FDI Screening Regulation. Published in late November, it paints a fascinating picture of inbound investment into the EU and points to future reforms that are set to transform Europe's notification process.

The issue of emerging technologies is the subject of our third article –specifically how foreign investment regimes assert jurisdiction over these transactions and how investors can assess whether their deal requires mandatory filing. We examine the core characteristics of national regimes from the United States to Australia, and pinpoint where the regulations in several important locations draw the line.

Then, we look at how foreign investment rules apply to companies pursuing stakebuilding strategies in the public markets. Corporate leaders buying listed securities are well versed in the requirements of mandatory offer regimes and merger control regulations, but it's often less clear how to navigate the rapidly evolving FDI landscape. Our experts clarify the filing thresholds in key jurisdictions around the world and offer practical tips for dealmakers on how to

Freshfields ➔

Freshfields

continued

structure their M&A transactions.

Finally, we would like to extend our sincere thanks to you for reading FI monitor since we launched in April 2021. We hope you have enjoyed the articles, and as ever if you would like to discuss any FDI issue in more detail we would be delighted to arrange a meeting. Likewise, we would welcome your feedback on how to improve the monitor and your ideas for topics to cover in future editions.

One year on, China remains in CFIUS's sights

It's been a year since Joe Biden was elected to the White House. As expected, CFIUS under this administration has continued to act aggressively to address perceived risks related to China, although the process overall has become more robust regardless of any Chinese nexus. Here, we examine key developments from the president's first year in office and look ahead to how the transactional landscape is likely to evolve through 2022 and beyond – including the prospect of CFIUS being able to reach a broader range of emerging technology transactions and the US government gaining the authority to restrict outbound investment into China.

China remains a key consideration

The number of new direct Chinese investments in the United States continues to be relatively low, due to both policy considerations in China and US regulatory scrutiny. But CFIUS scrutiny of Chinese investments in the United States still continues. For example, CFIUS has continued to aggressively reach out with respect to long-closed Chinese investments that were not notified to CFIUS, in some cases requesting the submission of a notice and imposing post-closing mitigation. CFIUS's reported ongoing review of the planned Chinese acquisition of Magnachip – a South Korean semiconductor company that has a holding company in the United States but few other assets – shows CFIUS's continued willingness to use its authority to address even risks that principally arise as a result of non-US activities.

China has loomed equally large even in transactions where there is no direct or indirect Chinese investment, but where the investor has a significant business presence in the PRC. CFIUS regularly scrutinizes transactions involving sensitive US technologies to assess whether the foreign investor's R&D relationships, joint ventures, manufacturing activities, sales activities and even its overall reliance on the Chinese market as a source of revenue could lead to risk of transfer of sensitive US technology to China. CFIUS diligence of any China nexus is becoming increasingly robust.

"Whether via law or executive order, it's possible the US government will be handed the authority to review outbound investments into China."

Regulatory change on the horizon?

Continued, deep concern in Washington over the risks posed by Chinese policies and competition could provide impetus for even more regulatory change. A number of proposals have been made in Congress to amend CFIUS authorities, including giving the committee the authority to review greenfield investment, and requiring it to review transactions involving sensitive personal data and address risk to food and agriculture, among a range of other proposals. Some do little more than codify existing CFIUS practice or are focused on Chinese government-related investors, but they are generally less than likely to be enacted. However, there is a greater chance that legislation or executive order will subject a broader scope of emerging and foundational technologies to CFIUS's "covered investment" (i.e., non-controlling but non-passive investment) jurisdiction (see our article on foreign investment jurisdiction on page 7) or give the government the ability to review US outbound investment into China through a CFIUS-like process.

More CFIUS resources equals more CFIUS scrutiny

CFIUS's increased resources have resulted in a series of changes, many of which are likely to have even more significant long-term impacts than the statutory developments in 2018. CFIUS staffing started to increase dramatically soon

after the new CFIUS legislation became effective in late 2018. The 2018 statutory changes, however, resulted in a much more modest increase in CFIUS workload than many expected, rising from 250 reviewable filings in 2018 to only 313 in 2020. This gave CFIUS the breathing room it needed to implement new processes and improve overall performance. Specifically, during this time, CFIUS established its new accelerated declarations process, implemented a new electronic case filing system, significantly reduced the time for providing feedback on draft notices, established new capabilities to identify and call in non-notified transactions, increased its mitigation monitoring capabilities, and significantly expanded its outreach and assistance to foreign governments considering establishing or strengthening their own CFIUS-like regimes.

However, probably because of a combination of increased M&A activity and increased CFIUS scrutiny, the committee's case flow this year has grown dramatically. By our estimate, CFIUS will have considered approximately 40–50 percent more filings this year than last. Our general assessment is that the committee dives more deeply into each transaction, with the number of requests for information even in the abbreviated declarations system often matching what one would normally expect in the notice process, though in a much more compressed time frame. CFIUS is also very active in calling in transactions that have not been voluntarily notified, mostly (but not exclusively) with a China nexus, though only a portion of these result in initiation of a formal CFIUS review process. While the overall percentage (12–14 percent) of CFIUS notices that result in mitigation has not changed in the past few years based on statistics through 2020, the threshold for aggressive CFIUS action continues to be lower than in most non-US jurisdictions, where substantial mitigation or prohibitions are rare.

European Commission looks back on first year of EU FDI Screening Regulation

On November 23, the European Commission issued its first annual report on the screening of FDI into the European Union. The Screening Regulation establishes a cooperation mechanism for FDI screening between the Commission and EU member states but leaves the decision on which investments to screen, approve, condition or block to each country under their domestic rules. In summary, the Commission and member states view the regulation positively as an important tool for monitoring and assessing FDI into the EU.

The Commission notes that only 11 member states had a national FDI screening mechanism when the regulation was tabled in 2017. However, by July 1, 2021 that figure had risen to 18, and during the reporting period 24 of the 27 member states either adopted a new screening mechanism, amended an existing one, or initiated a process to adopt or amend a screening mechanism. Only Bulgaria, Croatia and Cyprus are identified as having no publicly reported initiative underway, though the Commission expects it will only be a matter of time until all 27 EU countries have screening mechanisms in place.

"More than 90 percent of notifications submitted under the cooperation mechanism came from just five countries: Austria, France, Germany, Italy and Spain."

Inbound FDI falls – but not evenly across the board

In terms of FDI flows, COVID-19 had a harsher impact on FDI into the EU than it did globally, with investments down 71 percent from 2019 compared to 35 percent globally. Importantly, when looking at the origin of EU inbound investment, FDI did not decline evenly across the board. Investments from the largest sources, the US and UK, decreased by 35 percent and 21 percent, respectively. while those from China dropped by 63 percent (although China's overall share of non-EU investments into the EU was only 2.5 percent). There are likely many reasons for this decline, not least the impact of the pandemic, but tougher FDI scrutiny may well have played a role.

Overall, 11 member states submitted 265 notifications under the cooperation mechanism, although more than 90 percent of those came from just five countries: Austria, France,

Freshfields ➔

Freshfields

continued

Germany,Italy and Spain, all significant beneficiaries of foreign investment and countries that have the most active FDI regulators in Europe. The main sectors involved in the cases notified were manufacturing, ICT and financial services In total, 1,793 cases were reported to national screening authorities, 80 percent of which did not require formal screening. Of the remainder, only a relatively small proportion were prohibited (2 percent) or aborted (7 percent), while the remaining 12 percent were approved.

Forthcoming reforms set to transform the EU notification process

While around 30 percent of cases affected more than one member state, the Commission submitted opinions in less than 3 percent of all cases – which it says it will do only if required by the circumstances, the investor's risk profile or the criticality of an investment target. Nonetheless, some member states noted a number of practical challenges with the regulation, including the strain on resources, short timelines and the "overly burdensome" nature of information requests by the Commission and other member states. While the Commission has already taken steps to make improvements, for example by updating the notification form for investors and its FAQ document, it recognizes that more can be done. With this in mind, it has launched a comprehensive review and in due course will consider issuing guidelines for the benefit of member states and investors. This, and the expected convergence of national FDI rules in the next few years, is set to further transform the notifications of FDI in the EU and, hopefully, ease the administrative burden on investors who currently have to deal with a large number of parallel review procedures.

Sensitive technologies and sectors: what's in and what's out of foreign investment regimes?

Understanding the jurisdiction of FI regimes when it comes to sensitive technologies and sectors is critical to deal execution. So, what types of regulation are in place around the world? How do they define "sensitive"? And how do they differ in terms of filing obligations? We round up the key points for investors.

A central focus of most foreign investment review regimes is the protection of companies that produce sensitive technologies or operate in sensitive sectors. However, what the presence of such technologies or activities means for jurisdiction and mandatory filing requirements differs. As far as jurisdiction is concerned, regimes generally take one of three approaches:

i) jurisdiction depends on the target business operating within certain technology or sector areas;
ii) jurisdiction is general and independent of technology or sector; or
iii) a hybrid of the two.

Beyond jurisdiction, technology or sector may also determine whether a filing is mandated. The different approaches reflect different trade-offs for parties and the government.

"In some cases we have obtained clearance and safe harbor from CFIUS in less time than it took to obtain a lack-of-jurisdiction determination in France."

Sector/technology-dependent jurisdiction

Jurisdiction under some regimes (for example those in France, Italy and Spain) turns on broadly drawn "strategic sectors." Here, transactions that fall within a strategic sector (and meet any control or value thresholds) are often subject to a mandatory filing requirement. This approach has the advantage for parties and governments of entirely excluding transactions that fall outside of the sectors that the government deems most sensitive. However, for transactions within the designated sectors, parties cannot opt out of filing even when the transaction (whether because of the nature of the target or the identity of the buyer) is highly unlikely to raise concerns. For example, these regimes typically cover companies that resell goods in a strategic sector, even if they do not themselves develop or produce critical technology for use in that sector. Furthermore, because the government has no authority to review a transaction that falls outside of these sectors, the sectors' boundaries are not precisely defined.

As a practical matter, these soft sector definitions create uncertainty that itself often warrants a filing to obtain a formal jurisdictional determination as a prudential matter. This erodes the value of the sector- based approach for parties to some degree. For example, in some cases we have obtained clearance and safe harbor from CFIUS in less time than it took to obtain a lack-of-jurisdiction determination in France. Thus, the ability of authorities to provide a jurisdictional determination reasonably quickly is important to mitigating to some extent the uncertainty of the jurisdictional scope.

Sector/technology-independent jurisdiction

In some jurisdictions, the government has the authority to review transactions on national security grounds regardless of the target company's sector or technology. This is the case, for example, in Australia, Canada and the UK as of 2022. Only certain transactions, however, require pre-closing approval.

In Australia, all transactions are reviewable on national security grounds, but only direct investment in "national security businesses" requires a pre-closing filing (in addition to certain other land and media investments and certain other investments that exceed financial thresholds). The definition of "national security business" under Australian rules is generally made with reference to other regulatory regimes and involves relatively concrete criteria, creating somewhat less ambiguity than regimes that use vague sector labels. Canada mostly mandates pre-closing filings only with respect to a direct acquisition of a Canadian business that exceeds a certain value. However, Canada requires that most investments be notified to the government no later than 30 days after completing the transaction and can initiate a "national security review" of any transaction. In Canada, therefore, the principal decision for parties in most cases is whether the government is likely to have national security concerns with the transaction, in which case a pre-closing filing may be warranted even if it is not mandated.

Under the new UK National Security and Investment Act regime, which will commence on January 4, 2022, the UK government will have extensive powers to review any acquisition of "material influence" in a company, regardless of technology or sector. Notwithstanding the jurisdictional breadth of the regime, pre-closing filings will be mandated only for certain transactions involving targets that carry out specified activities in the UK in 17 sectors, which are defined in relative detail in 44 pages of secondary legislation (in some cases with reference to other regulatory regimes). For transactions that fall outside the scope of the mandatory regime, parties must make the same subjective determination as in Canada of the risk of a non-notifiable transaction being "called in," but with the overlay that acquisitions involving targets which undertake activities closely linked to one of the designated sectors are more likely to fall into this group than those that do not. Early indications are that many parties will choose to make precautionary voluntary notifications in the early days of the regime for legal certainty reasons given the five-year period for call-in of non-notified transactions post-completion.

Hybrid jurisdiction

The US regime uses a combination of the two approaches. CFIUS principally takes a sector- and technology-agnostic approach to jurisdiction; any transaction that results in foreign control of a US business is potentially subject to review and CFIUS, indeed, has reviewed transactions in a wide array of sectors. However, the committee also has authority to review non-controlling investments, but only in US businesses that design, produce or test critical technologies, those involved in critical infrastructure, and those holding certain types and volumes of sensitive personal data. A filing is mandated for non-government investors only with respect to critical technology companies.

Unlike regimes that have loosely defined sector categories, critical technology is categorized for CFIUS expanded jurisdiction applies), though a US business that does not export its products or technologies may not have bothered to classify them in the ordinary course leading to an accelerated (and often very technical) classification exercise in the context of a transaction.

There is, however, some risk that this technical, bright-line approach could change. Congress directed the US export control agencies to define controls for so-called "emerging and foundational technologies," which would then become critical technologies for CFIUS jurisdictional purposes. These agencies have moved cautiously, implementing only limited additional controls to date. This delay has prompted interest to more broadly defined concepts that would leave parties without a clear method of evaluating

Freshfields ➔

Freshfields

continued

whether their technology falls within CFIUS's non-controlling jurisdiction or triggers a mandatory filing. This could add material uncertainty to the scope of the US mandatory filing regime.

CFIUS is a necessary consideration in almost all control transactions, given CFIUS's sector-independent control jurisdiction, but companies have the leeway to make a risk-based filing decision in most instances. And for mandatory filings and non-controlling investments, where sector/technology is relevant, the lines at the moment are relatively well defined.

Given the divergent jurisdictional approaches and mandatory filing requirements, it is important to consider all aspects of a target's business – including the sectors in which it operates and its technology.

Stakebuilding in public M&A – where to draw the line for foreign investment

Dealmakers contemplating stakebuilding strategies in public markets have traditionally had to navigate a thicket of regulations, ranging from mandatory offer rules to merger control. However, the evolution of the foreign direct investment (FDI) landscape is now presenting an additional challenge – the need to obtain FDI clearance before proceeding with any share purchase that would bring the investor's overall shareholding above certain thresholds.

This is exacerbated by the fact that many jurisdictions lack bright-line guidance for foreign investment, while others have been lowering their thresholds for notification (some specifically aimed at minority acquisitions). A failure to understand which thresholds may be triggered – and when – can prove fatal as far as the deal is concerned. Recently, Yonghui Superstores had to abandon its proposed acquisition of an additional 10.14 percent stake in Zhongbai Holdings after building a material stake on the open market. Although the merger had been cleared by the Chinese competition authority, it ultimately fell through after being called in for a potentially lengthy national security review in China.

For dealmakers looking to engage in open market stakebuilding before proceeding with a formal bid, it's important to bear in mind that where such strategies have previously helped in securing foreign investment approval (see, for example, Midea's acquisition of Kuka) they may not present the same advantages in today's investment climate.

"Merger control rules tend to kick in when a party acquires control; the approach is more varied for FDI reviews."

When does stakebuilding trigger the need for FDI approvals?

Compared to merger control rules, which tend to kick in when a party acquires control (or at least material influence), there is a significantly more varied approach for FDI review (see table on page 12). Public bids, for example in the EU, are sometimes exempt from the standstill obligation in merger control (which prevents parties from closing the deal until they have received regulatory approvals), but where foreign investment is involved, these waivers are less common. A case-by-case assessment for each jurisdiction is therefore essential to avoid inadvertently triggering a mandatory FDI filing, particularly when engaging in early-stage stakebuilding.

Key points to consider include:

- Who is investing – in certain EU member states, non-EU/EFTA investors will face lower ownership thresholds for triggering a filing, among other heightened restrictions.
- The target's activities/sector – the sensitivity of the target is key to assessing FDI filing requirements, and sector-based variation in notification thresholds are common.

Indicative ownership thresholds* for merger control and FDI review (as of November 29, 2021 unless otherwise stated)

*Includes examples of shareholding, voting rights or control rights thresholds for select jurisdictions (including temporary rules introduced in France, Spain and Italy during the COVID-19 pandemic). Please note that other factors will need to be assessed to determine whether a transaction is subject to FDI/merger control review.

Jursidiction	Merger Control	FDI Review
China	Control or decisive influence, with a broad interpretation in practice	Substantial influence, with no "bright-line" rule. For certain sensitive targets, shareholding thresholds can be zero
France	Control (ownership or decisive influence)	Currently 10%, 25% or the acquisition of control, depending on the nationality of the investor and whether the target is a French-listed company
Germany	Control, 50%, 25% or material competitive influence	10%, 20%, 25%, 40%, 50% or 75%, depending on the nationality of the investor and target sector or, in some circumstances, other forms of influence
Italy	Control (dominant or decisive influence due to voting rights)	Several notifiable thresholds between 3% and 50%, or the acquisition of a controlling interest, depending on the nationality of the investor, target sector and whether the target is a listed company
Japan	20% or 50% (or lower if acquirer holds more than 10% and is a top three shareholder)	For Japanese listed and unlisted companies, 1% or more (subject to certain exemptions from pre-closing review)
Spain	Control (decisive influence)	10% or the acquisition of control
UK	50%, de facto control or material influence	Mandatory notification thresholds at 25%, 50% and 75% in key sectors; acquisition of material influence can be called in (in force from January 4, 2022)
United States	Control (50%) for foreign-to-foreign transactions, otherwise based on transaction value	No bright-line thresholds. Certain governance rights trigger non-control jurisdiction and control jurisdiction

Freshfields ➔

Freshfields

continued

What does this mean for dealmakers?

- **FDI analysis must be done up front and kept under continuous review**

  Failure to manage these processes proactively could also impact overall deal timetable strategy. It's important to remember that a limited increment in ownership through the purchase of a small shareholding can still trigger FDI filing requirements where it combines with an existing shareholding to cross a certain threshold – for example in Germany, Italy and the UK (under the incoming regime).

- **Managing multiple FDI filings**

  Where the target is engaged in sensitive activities, an incremental stakebuilding approach could mean that multiple FDI filings are triggered at different stages in the bid timetable – for example, for a listed target active in a defense or national security sector in Italy, acquisitions of shares may need to be notified separately for pre-clearance where the investor crosses 3 percent 5 percent, 15 percent, 20 percent, 25 percent or 50 percent shareholding thresholds.

- **Coordinating parallel FDI and merger filings**

  In most jurisdictions, the thresholds for merger control and FDI notification will be different. However, if both are triggered and the deal presents substantive antitrust and FDI risk, careful planning will be needed to align regulatory engagement and remedy strategies for both processes.

- **Keeping an eye on key risk areas and future developments**

  Governments around the world have increased their use of national security review procedures (for example Canada and China), tightened review thresholds or even introduced new regimes (the UK and a number of EU member states). Given the speed at which national governments have acted to close perceived gaps in foreign investment control, early awareness is critical to ensure the viability of stakebuilding and M&A strategy more generally.

Website: www.themandajournal.com

E-mail: info@themandajournal.com

Editorial Office: 215-309-5724

Orders & Subscriptions: For individual subscriptions, discounted multi-copy institutional subscription rates, or additional copies, please call 215-309-5724 or fax 215-309-5724.

THE M&A JOURNAL
the independent report on deals and dealmakers

Editor/Publisher **John Close**
Design and Production **John Boudreau**
Senior Writers **Gay Jervey, R. L. Weiner**
Writing/Research **Frank Coffee, Jeff Gurner, Terry Lefton**
Circulation **Dan Matisa**
Web Production **John Boudreau**

The M&A Journal, 1008 Spruce Street, Suite 2R, Philadelphia, PA 19107