SLAUGHTER AND MAY

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Foreign investment in the EU: a tale of competing tensions

There appears to be an emerging trend in Europe for governments to intervene in foreign takeovers of local companies in order to safeguard national interests and prevent the loss of key strategic industries overseas. However, this causes underlying tension with the widely-held ambition for their countries' economies to be open to foreign investment and free trade. As the G20 leaders **acknowledged** at the summit in Hamburg at the beginning of July 2017, the aim must be to "*identify strategies to facilitate and retain foreign direct investment*" and "*keep markets open noting the importance of reciprocal and mutually advantageous trade and investment frameworks*", and that "*legitimate trade defence instruments*" should not spill over into protectionism.

This article focusses on recent developments in the approach to foreign investment in the EU, Germany and the UK.

The EU looks towards legislating

The EU Merger Regulation (EUMR) provides that EU Member States may "*take appropriate measures to protect legitimate interests*" other than EU competition law considerations.[1] In practice, this means that a national government may conduct a parallel review of the relevant 'legitimate interest' considerations raised by the transaction, alongside the merger control review by the European Commission. The EUMR specifically recognises that (i) public security, (ii) plurality of the media, and (iii) prudential rules are 'legitimate interests', and Member States may submit other public interests to the Commission for consideration in the context of any merger it is investigating, provided they are compatible with the general principles of EU law.[2]

Some Member States, however, believe there to be a regulatory gap: under existing mechanisms, takeovers can be examined to ensure there is no distortion or restriction of competition and nearly half of the Member States have screening procedures for national security concerns, but this does not scrutinise foreign

For further information on any competition related matter, please contact the **Competition Group** or your usual Slaughter and May contact.

[1] Article 21(4) of the EU Merger Regulation (Council Regulation (EC) 139/2004).

[2] For example, references of UK water mergers to the Competition and Markets Authority for a regulatory assessment were sanctioned in Case No IV/M.567 – Lyonnaise Des Eaux/ Northumbrian Water.

investment sufficiently. France and Germany in particular are leading the call for the EU to restrict access to Member States' key industries, such as energy, banking and technology. The principal targets appear to be state-run Chinese companies seeking to acquire strategic assets deemed critical to national security by their home government. There is a growing imbalance between rapidly increasing Chinese investments in the EU and steadily declining European investments in China, which some stakeholders stress must be addressed.[3]

On 10 May 2017 the Commission **published** a Reflection Paper on Harnessing Globalisation, which reviewed the case for a common EU approach to investment from overseas. The Commission found that while "*openness to foreign investment remains a key principle for the EU and a major source of growth…concerns have recently been voiced about foreign investors, notably state-owned enterprises, taking over European companies with key technologies for strategic reasons. EU investors often do not enjoy the same rights to invest in the country from which the investment originates. These concerns need careful analysis and appropriate action*".

On 19 June 2017 the European Parliament's Committee on International Trade published a **proposal** for an act regarding the screening of foreign investments in strategic areas. It stated that "*non-EU investment can lead to the acquisition of entire European companies as part of strategic industrial policies, potentially causing significant damage to the EU economy, particularly in sensitive areas as regards security or industrial policy*". However it also noted that any screening mechanism must follow "*clearly defined and transparent criteria in order not to inadvertently dissuade foreign investors from going ahead with legitimate, market-driven bids*".

The Committee proposed that it was important to "*adopt a common European approach on this matter*", that includes extending the scope of existing protections to strategic sectors such as energy, transport, telecoms, health and water, and establishing a European Committee on Foreign Investment tasked with reviewing sensitive foreign investments. The European Council **agreed**. Whilst it confirmed that the EU will keep markets open and fight protectionism, it called for enhanced reciprocity in global investment and welcomed the Commission's initiative to analyse investments from overseas in strategic sectors.

Following these interventions, the Commission is expected to publish legislative proposals on how the EU could tighten screening of foreign investments to prevent hostile takeovers in key industries later this year. However, a difficult compromise may need to be reached as many smaller eastern and southern European economies rely heavily on foreign investment and remain staunchly in favour of a more strictly pro-trade approach.

Germany tightens its regime

On 12 July 2017 Germany adopted an amendment to the **German Foreign Trade Regulation** to allow the German Government to screen and ultimately block a wider range of foreign takeovers. In doing so, Germany has become the first EU country to tighten its rules on foreign investment. Commentators have

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[3] EU-China talks on an investment accord are under way but are progressing at a slow pace. Beijing has recently proposed new guidelines on foreign direct investment (which will enter into force on 28 July 2017) that will reduce the number of industries in which overseas investment is restricted. However, the EU Chamber of Commerce in China has reportedly described these changes as insufficient.

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largely suggested that the catalyst for change has been a number of Chinese takeovers of large European technology and innovation firms, including the acquisition last year of Kuka, the German robotics maker, by Chinese company Midea. In addition, the German Government withdrew approval for China's Fujian Grand Chip Investment Fund to buy German chip equipment maker Aixtron in October 2016 citing security concerns. The concern is that the existing regime does not adequately protect strategically important German interests and that, in particular, China is gaining too much access to key European technologies whilst shielding its own companies from foreign takeovers.

Currently the German regime allows the German Federal Ministry of Economics and Energy to review transactions where a non-EU investor acquires over 25 per cent of the shares in a German company in order to assess potential risks to national security or public order. The scope of the rules is largely restricted to the defence industry and companies involved in IT security. The amendment broadens the scope of the regime as the new rules will apply to companies that operate, or develop software for, 'critical infrastructure' (including in the energy, water, IT, finance, telecoms, health, transport and food industries), with the aim to prevent control of such technologies from being taken abroad. The amended regime will also double the review period, giving the Ministry up to four months to clear the transaction.

The German Economy Minister, Brigitte Zypries, has been quoted in the press as saying that Germany "*remains one of the most open economies in the world, but we also need to take fair competitive conditions into consideration…We owe that to our companies. They often compete with countries whose economies are not as open as ours*".

The UK's dichotomy

The UK has a long-standing policy of welcoming overseas investment in assets of all types and there are currently no legal or regulatory barriers, based on nationality, to non-UK entities making investments in UK assets. As an example, the infrastructure, energy and natural resources sectors are populated with investors of many nationalities. Investors in the water sector include companies from China, Singapore and Hong Kong and in the electricity generation and supply sectors, four of the 'Big Six' companies are overseas owned. However, recent transactions such as Vantiv's possible offer for Worldpay (a major UK technology company) have reignited the ongoing debate over foreign takeovers, which has previously come into the spotlight during Pfizer's attempt to acquire AstraZeneca and the sale of Cadbury's to Kraft.

Currently the UK Government is able to intervene in a UK or EU merger control review in very limited cases on the grounds of specified 'public interest intervention' criteria (namely (i) national security, (ii) criteria in relation to newspaper and media mergers, and (iii) maintaining the stability of the UK financial system). However, the Government also has the power to make an order to specify other public interest intervention criteria where it sees fit.

The UK Government has recently indicated that it will review the circumstances in which it can intervene in the merger control review of a transaction. It **suggested** in September 2016, in the context of the proposed Hinkley Point C nuclear power station project, that it would introduce "*a cross-cutting national*

security requirement for continuing Government approval of ownership and control of critical national infrastructure".[4]

In its September 2016 **submission** to the Business, Innovation and Skills Committee's inquiry into the Government's industrial strategy, however, the UK Competition and Markets Authority (CMA) highlighted a number of factors that it believed should be taken into account when considering changes to the public interest intervention regime. In particular, it warned that careful consideration would need to be given to whether intervention in mergers on non-competition grounds could harm the "*UK's reputation internationally as an open, competitive place to do business*" and/or, by encouraging other countries to implement similar controls, limit the scope for UK companies to do business abroad.[5]

The proposal to reassess the scope of the public interest intervention criteria was nonetheless echoed in the Conservative Party's 2017 election **manifesto**. This stated that the Conservative Government would "*take action to protect our critical national infrastructure*" and "*ensure that foreign ownership of companies controlling important infrastructure does not undermine British security or essential services*". It noted that the Government has "*already strengthened ministerial scrutiny and control in respect of civil nuclear power and will take a similarly robust approach across a limited range of other sectors, such as telecoms, defence and energy*". The Government clarified that it "*welcome[s] overseas investment and want[s] investors to succeed here but not when success is driven by aggressive asset-stripping or tax avoidance*". It pledged to update the rules that govern mergers and takeovers, including requiring (i) bidders to be clear about their intentions from the outset of a bid process, (ii) that any undertakings made during the process will be legally enforceable afterwards, and (iii) that the Government may pause a bid if it requires additional scrutiny. These pledges were repeated in the legislative agenda laid out in the **Queen's Speech** of 21 June 2017, which stated that the Government will *"bring forward proposals to ensure that critical national infrastructure is protected to safeguard national security*".

Conclusion

Foreign investment is increasingly becoming a 'hot topic' in Europe and this has resulted in some fundamental tensions becoming evident in the EU's and some Member States' economic and political policies. Governments will need to find a way to balance their stated aims to restrict certain types of foreign investment in key domestic sectors, with their largely pro-trade stance and the risk of deterring foreign investment that is important to their economies. The UK Government in particular will need to

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[4] Currently 'national infrastructure' is **defined** as "*those facilities, systems, sites and networks necessary for the functioning of the country and the delivery of the essential services upon which daily life in the UK depends*" and is categorised into 13 sectors: chemicals, civil nuclear, communications, defence, emergency services, energy, finance, food, government, health, space, transport and water. 'Critical national infrastructure' is defined as "*those critical elements of national infrastructure (facilities, systems, sites, property, information, people, networks and processes), the loss or compromise of which would result in major detrimental impact on the availability, delivery or integrity of essential services, leading to severe economic or social consequences or to loss of life*". National infrastructure is categorised as 'critical' according to the UK Government's 'Criticality Scale', which assesses the severity of impact which would result from disruption of the infrastructure asset.

[5] See further this previous **edition** of our Competition and Regulatory Newsletter and our **client briefing** "What does the UK Government's proposed industrial strategy mean for UK competition policy?".

reconcile its proposals to limit certain foreign investments with its ambitions regarding the UK's future trade relationships post-Brexit with the EU and the rest of the world.

There is also the question of the relationship between established merger control, which addresses competition concerns, and (potentially enhanced) foreign investment screening. Modern competition law and policy has tended to focus on economic analysis of the market and on the need for an independent regulator that is removed from non-economic influences such as the social or national benefit of a foreign takeover. Indeed, Competition Commissioner Margrethe Vestager reportedly stated recently that although she believes that national security concerns in foreign corporate takeovers could be "*completely legitimate*", proposals to screen foreign investment in the EU should be "*complementary*" to the regulator's power to assess the impact on competition, as the two are "*of a different nature*".

It remains to be seen to what extent EU Members States will follow in the footsteps of countries such as Australia, Canada, Japan and the US that already operate foreign investment screening regimes which are not limited to national security, but also extend to critical technology and infrastructure.

Other developments

Merger control

Tesco/Booker fast-tracked to Phase II

On 12 July 2017 the CMA **announced** a fast-track referral to Phase II of its investigation into the proposed merger between Tesco plc and Booker Group. This followed a request for such a referral made by the parties on 27 June 2017. The CMA's approval is a precondition to the closing of the £3.7 billion transaction, which was announced on 27 January 2017. The full text of the decision was **published** on 21 July 2017.

The CMA's Phase I decision suggests that it has identified potential competition concerns arising from horizontal and vertical overlaps between Tesco stores and Booker-supplied stores in more than 350 local areas. The CMA considers that shoppers could face worse terms when buying their groceries in these areas. In addition to two local areas where concerns have been identified in relation to horizontal overlaps between Tesco and Booker stores, the CMA has identified potential concerns that in certain geographic areas post-merger, the merged entity may have the ability and incentive to (i) worsen the retail offering in its Tesco stores, such that customers may switch to Booker's symbol stores, and/or (ii) reduce the wholesale services or terms it offers the Booker symbol group stores it supplies, in order to drive customers to their local Tesco instead. No conclusion was drawn on other relevant issues raised by third parties in light of the fast-track referral. As a result of the fast-track referral, the investigation has passed to a new set of decision-makers - an inquiry group comprised of four of the CMA's independent panel members. The inquiry group has a 24-week statutory period to issue a Phase II decision, with the decision expected before Christmas 2017.

There have been a number of previous cases where the fast-track procedure has been used, including most recently BT/EE, Ladbrokes/Coral and Central Manchester University Hospitals/University Hospital of

South Manchester. For a case to be fast-tracked, two conditions must be met. First, the test for a Phase II reference must be satisfied, namely that the CMA must have a reasonable belief, objectively justified by evidence, that there is a realistic chance of the proposed merger substantially lessening competition in any UK market. Secondly, the notifying parties must have requested and given their consent for the use of this procedure. The parties can request fast-tracking at any point during the course of the investigation.

Antitrust

CMA launches cartel screening tool for procurers

On 13 July 2017 the CMA launched a free cartel screening tool for procurers. In collaboration with Spend Network, the CMA has developed a tool that uses algorithms to test tender documentation and bid prices to identify behaviour that may indicate cartel activity. Spend Network's February 2016 **report** outlines the tool's usage methodology and development. Users must provide certain data for analysis: the invitation to tender document, bid submissions from all bidders, the identity of the winning bidder and the pricing information in each bid. The algorithms enable the tool to test for suspicious signs in three key areas: (i) number and pattern of bidders, (ii) pricing patterns, and (iii) document origin and low endeavour submissions. The pass/fail threshold and weighting of each metric can be adjusted and further tests can be added to tailor the tool to specific situations and different regions and industries. Ultimately, the tool creates a suspicion score for the tender exercise, which indicates tenders that are more likely than others to be suspect. Although a high score does not *prove* the existence of a cartel, it can prompt procurers to re-examine the bid documentation and ask questions.

The tool is **freely available** as an application that can be downloaded and used within procurers' own systems. This allows the tool to take on a life of its own and increases the scope for future tailoring and development. Contrary to a CMA-hosted tool, this approach also means that users need not share data to use the tool.

Regulatory

FCA launches market study into investment platforms

The Financial Conduct Authority (FCA) **announced** a market study into investment platforms in its 2017/2018 Business Plan and, on 17 July 2017, it **published** the terms of reference of this market study, delineating its scope and the areas to be covered. It will focus on whether competition between investment platforms works in the interests of consumers. The FCA considers that investment platforms are an increasingly significant part of the retail distribution landscape. As the market becomes progressively more vertically integrated, the question arises, however, whether commercial relationships between platforms, asset managers, discretionary investment managers and financial advisers have the potential to distort competition by encouraging platforms to compete in the interests of those with which they have commercial relationships rather than in the interests of the consumer.

The FCA's terms of reference define a platform service as a service that offers access to third party investment products. In recognition of the wider distribution landscape, however, the FCA has adopted a broad definition of 'platforms'. This includes: (i) platforms and other firms that offer access to retail investment products through an online portal, whether direct-to-consumer or intermediated, (ii) other intermediaries who provide retail investors with services similar to those offered by a platform but without necessarily providing access to third party investment products, (iii) product and wrapper providers who use platforms to distribute their products, (iv) technology providers to whom platforms outsource services, and (v) fund ratings and data providers whose information is used and distributed by platforms. The market study will explore six key topics: (i) how platforms compete to win new and retain existing business, (ii) barriers to entry and expansion, (iii) commercial relationships, (iv) business models and platform profitability, (v) the impact of advisers, and (vi) customer preferences and behaviour.

In terms of next steps, the FCA is inviting feedback on the scope of the market study by 8 September 2017. An interim report presenting preliminary conclusions (and, if necessary, potential remedies) is expected by summer 2018.

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