Expansion of foreign investment controls in the UK and beyond – latest developments

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Leading regulatory regimes around the world are increasingly calling upon and actively bolstering their foreign investment controls. This article discusses the latest developments in the UK and other key jurisdictions in this area. It concludes that the increased political scrutiny of possible national security implications arising from international buyers acquiring local businesses introduces, or will introduce, significant additional complexity for certain transactions (including implications for timing).

UK Government to toughen powers to protect national security

The UK Government, under Prime Minister Boris Johnson, recently announced that it would legislate to toughen its powers to scrutinise and intervene in transactions on national security grounds. According to the Government one of the main benefits of the new legislation will be to allow it to "*scrutinise investments and consider the risks that can arise from hostile parties acquiring ownership of, or control over, businesses or other entities and assets that have national security implications*". It also wants to ensure that "*hostile parties or groups cannot circumvent our rules on a technicality by acquiring an asset rather than acquiring the business itself*". The three main elements of the legislation will be:

- A notification system, allowing businesses to flag transactions with potential security concerns to Government for screening (it is not specified whether this will be mandatory);
- Powers to mitigate risks to national security – by adding conditions to a transaction or blocking as a last resort (and sanctions for non-compliance with the regime); and
- A safeguarding mechanism for parties to appeal where necessary.

The new powers will be "economy-wide" and apply to "businesses of any size", "*reflecting the need for flexibility to address national security risks wherever they arise*".

The current Government's far-reaching proposals lack detail but appear to build on and resemble proposals published by previous UK Prime Minister Theresa May's Government, in July 2018, for a standalone national security regime (with voluntary notification), which, according to Government estimates, would result in 200 national security notifications each year (see Client Briefing).[1] By comparison, there have been 10 public interest interventions on national security grounds since 2002 under the Government's existing powers.

While the latest proposals emphasise that the Government expects to quickly rule out national security risks in most cases, experience of merger control and other foreign investment regimes (such as CFIUS in

[1] The detailed proposals of May's Government were set out in a White Paper, which was the subject of a public consultation that ended in October 2018. The dedicated Government website indicates that the Government is analysing the feedback and will use the responses to the White Paper "*to refine these proposals ahead of the introduction of primary legislation*".

the US) suggests that the reviews inevitably become front-loaded over time, in particular through pre-notification discussions with no binding deadline.

The continuing political uncertainty in the UK and upcoming general election mean that it is unclear when, and if, the new powers will come into force. However, as discussed below, the global trend towards increased scrutiny suggests that the UK will update its national security screening regime at some point.

Earlier, more limited, changes

The proposals for a new foreign investment screening regime in the UK follow modifications made in June 2018 to the existing Government powers to intervene in transactions on public interest – including national security – grounds. The existing powers can only be used to intervene in transactions which qualify for review under the UK or EU merger control regimes (unless they involve a "relevant Government contractor" (current and former Government contractors holding confidential information relating to defence)). The 2018 changes expanded the scope of the Government's existing jurisdiction to intervene in transactions in the military and dual-use, computing hardware, and quantum technology sectors in the UK by reducing the merger control thresholds for transactions in these sectors. As of 18 October 2019 these new powers have been used in 3 cases (Gardner Aerospace Holdings/Northern Aerospace, Connect Bidco/Inmarsat and Advent International/Cobham).

Expanding powers in other key jurisdictions

Prime Minister Johnson's Government defends updating the powers by noting that this is "*consistent with many of our major partners and allies around the world, including countries such as Australia, Japan, Germany, and the United States of America*".

There is indeed an expansion of (stricter) foreign investment screening powers across the globe. For example:

- Germany amended its Foreign Trade Regulation, to make it easier for the German Government to initiate an in-depth review of foreign investment, following the Government's blocking of a Chinese fund's takeover of chip equipment maker Aixtron in 2017. The amendment allowed Germany to investigate the acquisition of over 25 per cent of a domestic company by a non-EU/EFTA company if the acquisition could lead to risks to public order or security.[2]
- In 2018 the US passed legislation to expand CFIUS' jurisdiction to review transactions involving foreign persons (the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA)). The US Treasury Department recently published proposed rules implementing the changes, including (i) extending CFIUS' jurisdiction to "covered investments" in businesses producing critical technologies, handling critical infrastructure or maintaining personal sensitive data of US citizens, even if the transaction does not provide foreign investors with control and (ii) expanding CFIUS' jurisdiction by imposing a

[2] In addition to this cross-sector regime (e.g. for critical infrastructure activities), there is also a sector-specific screening regime (for target companies in the military and IT security sectors). In December 2018 the scope of both regimes was broadened again by lowering the threshold for reviews from 25 per cent to 10 per cent of the voting rights in a domestic company in certain circumstances.

mandatory pre-closing declaration requirement for foreign investments involving a substantial foreign government interest.[3] The rules are expected to come into force in early 2020.

- In Japan, proposed changes to the Foreign Exchange and Foreign Trade Act will (i) lower the minimum stake foreigners can buy in certain listed Japanese companies without prior Government approval (from 10 per cent to 1 per cent) and (ii) require foreign directors to seek permission before they sit on the boards of Japanese firms in sensitive industries. Parliament is expected to pass the legislation by early December 2019.

The UK Government's proposals also follow the EU's adoption earlier this year of a regulation establishing a framework for screening of foreign direct investments into the EU on the grounds of security or public order (see Client Briefing). The regulation should apply as from 11 October 2020.[4]

Implications for investors

While many Governments emphasise that the beefing up of their powers in this area is a proportionate response to a real threat, the increased scrutiny introduces significant additional complexity for certain cross-border transactions, including implications for deal evaluation, planning and timetable. Investors will have little choice but to adjust to what risks becoming the 'new normal'.

[3] At present, under the FIRRMA Pilot Program introduced in November 2018, mandatory declarations apply to foreign investments in any US business that deals with "critical technologies" that are "*utilized in connection with the US business's activity*" in certain listed industries (such as chemicals and petrochemicals manufacturing, electronic computer and computer storage device manufacturing, aerospace manufacturing, and R&D in nanotechnology and biotechnology). Parties to a transaction covered by the pilot program are required to submit a mandatory declaration to CFIUS at least 45 days prior to the expected date of completion and failure to file could attract a civil monetary penalty up to the value of the transaction.

[4] The most significant change brought by the regulation is to introduce a mechanism for cooperation and information sharing between the European Commission and EU Member States in respect of national-level screening of foreign direct investment. So far, 15 Member States have notified the Commission that they have foreign direct investment screening mechanisms (Austria, Denmark, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, Netherlands, Poland, Portugal, Romania, Spain, and the UK). For more on the EU framework for investment screening, see: https://trade.ec.europa.eu/doclib/press/index.cfm?id=2006

Lisa Wright
T +44 (0)20 7090 3548
E lisa.wright@slaughterandmay.com

Shweta Vasani
T +44 (0)20 7090 3928
E shweta.vasani@slaughterandmay.com

Nele Dhondt
T +44 (0)20 7090 4023
E nele.dhondt@slaughterandmay.com