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Outbound Chinese Investment into the EU: What You Need to Know about Regulatory Roadblocks

Chinese outbound investment in the EU has been growing steadily, hitting a record €20 billion in 2015 and remaining strong in 2016. While most European economic actors perceive this trend as positive, there are some indications that regulators and policy makers are paying particular attention to EU M&A transactions by Chinese investors. Understanding existing regulatory structures – some of which may be implicated by Chinese outbound investment in non-intuitive ways – is necessary to effectively structure transactions in a manner that minimises deal-related regulatory risk.

Foreign Ownership Restrictions

Restrictions on foreign ownership in sensitive sectors are common in Europe. While some of the limitations are predictable (since they relate to sectors that are sensitive (eg, defence)), other limitations may be less intuitive. Below, we set out the main characteristics of foreign investment regimes in major European jurisdictions and also explain how, in some cases, investments in those jurisdictions could attract scrutiny by the Committee on Foreign Investment in the US ("CFIUS") – particularly given the more aggressive approach recently taken by CFIUS.

France

Foreign investments in strategic sectors in France require prior authorisation by the French Finance Ministry. Strategic sectors include defence, information technology, energy, transport, water, public health and telecommunications but also more unusual sectors such as private security services and the gambling industry.

For non-EU investors, the prior authorisation regime applies where a foreign investor (1) acquires control of or acquires a stake of 33.33 percent of the share capital of a French target, or (2) acquires all or part of a French business. The Finance Ministry has two months to complete its review and the transaction will be deemed as authorised if the Finance Ministry does not respond within this period.

If a transaction in a strategic sector is completed without the prior authorisation of the Finance Ministry it will be considered void. Criminal sanctions may also apply for non-compliance with the authorisation regime.

Germany

The German Federal Ministry for Economic Affairs and Energy (“BMWi”) may restrict or even prohibit investments by foreign companies in sensitive industries, namely in defence and encryption technology. Similar rules also apply to the acquisition of a company that operates a high-grade earth remote sensing system. Relevant investments must be notified to the BMWi and are suspended until the BMWi grants its approval. If the BMWi does not initiate a formal review within one month from notification, approval is deemed to be granted.

German laws also provide for a general foreign investment review. If a non-EU investor acquires 25 percent or more of the voting rights of a domestic company and the acquisition could threaten German public order or security, the investment could be restricted or blocked. These types of transactions do not need to be notified, but the BMWi may conduct an ex officio review within three months of the acquisition. The BMWi then has two months to review the transaction from the time that it has received all relevant information. Non-EU investors can request a certificate of non-objection from BMWi prior to closing to avoid uncertainty, although the BMWi’s certificate can be withdrawn if new information comes to light.

This happened recently when the Chinese Fujian Grand Chip Investment Fund tried to acquire German semiconductor equipment producer Aixtron. Fujian Grand Chip had obtained a certificate of non-objection from the BMWi, only to see it withdrawn, because of new information that Aixtron had know-how in security-related technologies (that was particularly relevant for the defence sector). While in general, German policies and laws continue to welcome and encourage foreign investment, the Aixtron case demonstrates that certain foreign investments are attracting increased attention from the BMWi. In the case of Aixtron, Fujian Grand Chip Investment Fund withdrew its takeover offer following President Obama’s decision in December 2016 to block the US portion of the deal.

Finally, specific restrictions apply to both national and foreign investors regarding acquisitions of targets operating in certain regulated industries, such as financial services, insurance or media.

Italy

Under Italy’s foreign investment control regime, the Italian government has certain “golden” powers to veto or impose conditions on the purchase of interests by non-EU investors in certain Italian companies. The restriction relates to acquisitions of stakes in Italian companies that own strategic assets (eg, relating to telecommunications, energy, defence, aerospace and certain infrastructure).

Relevant transactions must be notified to the Italian government and cannot be completed pending the government's review. Once a notification has been made, the government has 15 working days to review the transaction and raise any objections. This period may be extended if the government requests additional information. If the government does not exercise its powers during the review period, the proposed transaction can be completed.

In addition to foreign investment control, Italian law also limits the acquisition of equity stakes by foreign investors in supervised entities (eg, banks, payment institutions).

Spain

Acquisitions of Spanish companies by non-EU investors are generally unrestricted and, other than the exceptions described below, typically require only a post-closing declaration to the Spanish Ministry of Economy.

Pre-closing authorisation is required for investments in the Spanish defence sector. These investments require prior notification to the Ministry of Defence and authorisation by the Council of Ministers, unless the investments represent an acquisition of a stake of less than 5 percent in a publicly-listed company (provided the investor does not acquire management rights).

A pre-closing declaration is required for investments originating in tax havens or for some investments in real estate destined for diplomatic or consular offices. Finally, certain sector-specific restrictions also apply to foreign investments in regulated sectors, such as telecommunications, radio and television, energy and financial services.

United Kingdom

Generally, the UK government does not restrict foreign ownership of businesses in the UK, although there are special rules relating to ownership in certain industries such as airlines and financial services.

Deal-making in the UK is generally free from political interference and government intervention has been limited. The government does have the power to regulate and potentially block acquisitions through a public interest review of transactions in strategic sectors (such as energy, media and defence) or in order to preserve the stability of the financial system. While the new Prime Minister, Theresa May, has signalled a more interventionist approach in takeovers of strategically important UK businesses by foreign acquirers, details remain unclear. However, it will be important to consider the implications of the potential new regime: foreign acquirers are acting mindfully of the potential new regime and undertaking informal discussions with the UK government in appropriate cases.

United States

Chinese investors in EU businesses must also consider the application of US foreign investment rules in cases where the EU target has operations in the US. For example, it is not uncommon for CFIUS – a committee of government agencies charged with reviewing certain transactions that may threaten US national security – to review transactions involving non-US buyers and sellers. Indeed, CFIUS has broad jurisdiction and may review any transaction whereby a non-US entity may obtain control of a "US business" – where that term is specifically defined to include the US operations of a foreign parent.

If CFIUS has concerns about a deal, it may ask the parties to agree to mitigation measures, such as post-closing operational restrictions, and in rare cases may recommend that the US President block or suspend the US portion of an otherwise offshore acquisition. Notably, CFIUS concerns have effectively scuttled several recent deals involving non-US parties, using relatively minor US operations of the target as a basis for jurisdiction.

For example, and as discussed above, President Obama recently decided to block the US portion of the acquisition of Aixtron by the Chinese Fujian Grand Chip Investment Fund. CFIUS had jurisdiction based on Aixtron's US assets. CFIUS recommended that the US President block the US portion of the transaction because of concerns about the military applications of the technology Fujian would have obtained. Although decisions to block transactions are very uncommon (ie, this was only the third transaction ever blocked by a US President) this recent case illustrates CFIUS's ability to cast a wide net, especially with respect to investments by Chinese buyers, which are increasingly subject to scrutiny.

The Aixtron case demonstrates why parties to deals involving Chinese investment in the EU should consider whether the target has assets or operations in the US and, if so, the nature of those operations. This analysis should inform the parties' evaluation of deal risk and decisions with respect to allocation of that risk. This analysis should also inform expectations with respect to transaction timelines, which turns in part on whether the parties decide to proactively notify CFIUS of their transactions. Although filing a CFIUS notice is voluntary in the first instance, doing so is often prudent, particularly if the target's business involves sensitive industries (eg, defence, energy assets, ports, airports, telecommunication systems). If CFIUS clears a transaction before closing, the transaction typically remains cleared forever. By contrast, in the absence of a clearance, CFIUS may initiate a review (and, in rare cases, force a divestiture) at any time – even years after closing.

Merger Control Review

Separate from foreign investment regimes, investments in European assets or businesses can trigger merger control reviews in a number of jurisdictions. In the EU, the merger review can be conducted either at EU level (by the Commission) or at Member State level (by national competition regulators). The purpose of merger control in Europe is to prohibit or impose conditions on transactions that would otherwise significantly impede competition.

Which regulator will review a transaction will generally depend on the buyer and target revenues. If the revenues are above the EU thresholds, then the Commission will conduct the merger review; otherwise national competition authorities will look at the transaction (assuming national review thresholds are met). When the Commission has jurisdiction to review a transaction, national competition authorities do not conduct a review: this "one-stop-shop" system is beneficial to companies since it reduces costs and red tape.

Particular attention is warranted where transactions involve Chinese state-owned enterprises ("SOEs"). These transactions can trigger EU merger control, even if the SOE in question has very limited activities in Europe. This is because the Commission has, recently, found that the turnover of a broader set of SOEs should be taken into account when considering whether a transaction qualifies for review under EU merger rules. In its EdF/China General Nuclear Power Corporation ("CGN") decision, the Commission considered the revenues of CGN's owner, the Central Chinese Assets Supervision and Administrative Commission ("SASAC"), for the purpose of determining jurisdiction, because CGN did not enjoy autonomy from SASAC in its decision-making. The Commission's approach in EdF/CGN decision means that the antitrust implications of SOE investments must be assessed carefully to avoid unexpected delays from regulatory concerns.

Mandatory and Suspensory Notification

When an acquisition meets the EU thresholds, notification is mandatory and the transaction cannot close before clearance. Failing to notify a reviewable transaction or implementing the transaction before clearance can attract significant fines in Europe (up to 10 percent of the aggregate turnover).

Timetable

The Commission has 25 working days from the formal submission of the notification to conclude its Phase I investigation (or 35 working days if the parties offer remedies). The Commission may open a Phase II review if it is concerned about the effects of the transaction on competition. A Phase II review lasts 90 working days (although this is often extended). At the end of a Phase II review, the merger is either approved, approved with remedies or prohibited.

Conclusion

Foreign investment and merger control reviews are "standard procedure" for many outbound Chinese investors. While for many types of investments these reviews are straightforward or even unnecessary, in certain instances obtaining regulatory approvals can be a complex exercise. Creating a plan at the early stages of investment is necessary to assist Chinese investors to effectively navigate the regulatory maze and avoid unexpected delays.

This article was prepared with the valuable assistance of the following Latham lawyers: Harald Selzner (Partner, Düsseldorf); Stefano Sciolla (Partner, Milan and Rome); Pierre-Louis Clero (Partner, Paris); Richard Butterwick (Partner, London); Martin Saywell (Partner, London); Jana Dammann (Counsel, Hamburg); Zachary Eddington (Associate, Washington DC) and Sophia Stephanou (Knowledge Management Lawyer, Brussels).

Héctor Armengod

Latham & Watkins, Partner

Héctor Armengod is a partner in the Brussels office of Latham & Watkins and a member of the firm's global Antitrust & Competition Practice. He focuses his practice on EU and Spanish competition law. In particular, Mr. Armengod represents clients in merger control proceedings before the European Commission and the Spanish competition authority and coordinates merger control filings in multiple jurisdictions globally. He also represents clients in major European Commission cartel and Art. 102 TFEU investigations. Mr. Armengod has extensive experience in various sectors including pharmaceuticals, medical devices, IT, automotive and retail.

Les Carnegie

Latham & Watkins, Partner

Les Carnegie is a partner in the Washington, D.C. office and co-head of the Export Controls, Economic Sanctions & Customs Practice. He has extensive experience representing clients before the Committee on Foreign Investment in the United States ("CFIUS"). Mr. Carnegie advises US and non-US clients on issues of national security

arising in international trade, including US economic sanctions, export controls, and national security reviews of foreign investments in the United States by CFIUS. Mr. Carnegie has counseled foreign government-owned buyers, private equity investors, and public and private companies in a variety of industries on negotiating resolutions of challenging CFIUS reviews.

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