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EU Poised to Enact a "European CFIUS": Four Considerations for Cross-Border M&A

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On December 11, 2018, the International Trade Commission of the European Parliament approved the political agreement between the European Commission (the "EC"), the Council of the European Union (the "Council") and the European Parliament regarding the establishment of a new framework to review foreign investment into the EU on national security grounds. The proposed regulation (the "Regulation") reflects a significant step forward in the EU's efforts to establish EU-wide national security investment review mechanisms. Although the precise timing of implementation of the Regulation remains uncertain (and still requires formal approval of the Council and the European Parliament), it is generally expected to become effective in Q1 2019. Parties considering transactions involving a European target should carefully consider how the Regulation's forthcoming implementation may affect deal feasibility, timing and cost.

The View from Europe

While 13 out of the 28 individual EU member states maintain processes to review the national security impact of foreign investments, there is currently no EU-wide mechanism to address national security-specific concerns about an investment in one or more EU member states. Moreover, EU member state processes vary widely, including with respect to review timing (e.g., pre-closing, post-closing), applicable monetary thresholds, sectors that may be considered "sensitive" and the scope of disclosure required. The planned Regulation focuses on implementing an information exchange and transparency mechanism amongst EU member states and the EC with respect to national security investment screening in EU member states.

The Regulation reflects increasing Western skepticism of foreign direct investment on national security grounds, following recent significant changes in the U.S.' process for

reviewing foreign investments. And, it is consistent with the zeitgeist in other advanced industrial Western countries: Canada, Australia and Germany have recently taken steps to upgrade their own national security investment review processes. These developments largely reflect shared concerns regarding Chinese strategic industrial policies that have been implemented in part through acquisitions in the EU and the U.S. of "critical technology" companies. Looking forward to 2019, companies and investors should expect that global scrutiny of foreign direct investment will continue, with far-reaching effects on transaction timing, certainty, feasibility and cost.

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We discuss below four noteworthy aspects of the Regulation and related key takeaways.

1. The Regulation provides for screening of investments on the grounds of "security and public order."

The Regulation makes clear that EU member states may interpret "security and public order" broadly, with consideration given to:

- Critical technology and dual-use items (e.g., cybersecurity, artificial intelligence, robotics, semiconductors, biotechnologies);
- Critical infrastructure, whether physical or virtual (e.g., health, transportation, communications infrastructure, energy, data processing or storage, defense, investments in real estate used for infrastructure);
- Critical inputs (i.e., energy, raw materials and food security);
- Access to sensitive data (including personal data), or the ability to access such data; and
- Media pluralism and freedom.

The Regulation provides that EU member states may also consider:

- Whether the foreign investor is government-controlled (including state bodies or armed forces, through ownership or significant funding);

- Prior involvement of the investor in activities affecting security or public order of the EU member state; and
- The risk of the foreign investor's engagement in illegal activities.

Takeaway: Determining a prospective transaction's national security risk profile requires a specialist assessment of a target's products and services, customer base, export control profile, facility locations and other matters. Investors should not assume that any company — regardless of industry sector — would not present potential national security sensitivities. In addition, the structure and identity of the investor should be considered.

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2. The Regulation provides for the establishment of information-sharing practices among EU member states.

Under the Regulation, EU member states will need to inform the EC and other EU member states of investments undergoing national security reviews in their respective countries. If other EU member states and the EC elect to comment on an ongoing review, they may request additional information from the EU member state with jurisdiction o ver such review. EU member states that have implemented national security regimes will be obligated to submit annual reports to the EC with details on their national security review processes, including the outcomes of reviews. All EU member states, regardless of whether they have implemented national security regimes, will be obligated to provide aggregated information on the foreign direct investments that took place in their territories on an annual basis.

Takeaway: Because information-sharing among EU regulators will likely increase, investors considering deals that may be notified to one or more national security review regulators should ensure that the substance and timing of disclosure to such regulators is carefully choreographed. Disclosure should also account for information provided to CFIUS, which is newly empowered to share information with U.S. allies under the Foreign Investment Risk Review Modernization Act ("FIRRMA"). Transaction

parties should likewise assume that information shared with national security regulators will be checked against public and non-public information (e.g., information obtained through intelligence activities).

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3. Transactions involving Chinese investors will likely be subject to heightened scrutiny.

While the Regulation's requirements will apply by their terms to all non-EU investors and the Regulation requires that EU member states maintain non-discriminatory review procedures, several proponents have cited Chinese investments in EU technology companies, particularly from state-owned enterprises, as a key impetus for adopting an EU-wide screening mechanism. China, for its part, has taken notice of the EU's efforts to move forward on the Regulation: One Chinese state-owned media outlet criticized the proposed EU regime as reflective of the U.S.' "*unilateral and protectionist policies*."

Takeaway: Despite the non-discriminatory approach of the Regulation, transactions with a direct or indirect nexus to China will likely face more regulatory headwinds. Non-Chinese private equity sponsors should ensure that their due diligence for an investment accounts for the extent to which participation by Chinese limited partners ("LPs") and/or co-investors may affect a national security regulator's evaluation of the transaction under consideration.

4. Implementation of the Regulation will likely prompt EU member states to establish new and/or amend existing national security regimes.

While fewer than half of the EU member states have currently established national security regimes, the implementation of the Regulation will likely prompt other EU member states to consider establishing new national security review regimes or amending their current review mechanisms to better align with the Regulation.

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