As concern has grown that the economic fall-out from the COVID-19 pandemic may lead to foreign investors seeking to acquire undervalued strategic assets, national governments have been rapidly tightening their foreign investment control rules to protect sensitive industries, with a particular focus on healthcare. Meanwhile, the European Commission has urged Member States to make full use of their screening mechanisms in order to protect key healthcare and research businesses critical to the fight against the virus. Intense scrutiny and possible prohibition should be expected in these sectors.

But governments are also focussing on other opportunistic takeovers of companies suffering from the rout across the stock markets, and are expected closely to review takeovers of generally important companies, including critical infrastructure companies, key technology companies and national champions. Acquisitions of targets in other sectors which are not generally considered sensitive from an economic and political view are less likely to give rise to concerns – yet even for these transactions issues may arise in certain circumstances, and reflect a political climate which has become much more hostile to foreign investment over recent years.

1 Foreign investment control in Europe – even more important in times of COVID-19

The COVID-19 outbreak is having a significant impact on the EU economy, as most Member States have implemented containment measures to curtail the spread of the virus. As concern has grown that the economic fall-out from the pandemic may lead to opportunistic acquisitions by foreign investors of undervalued strategic assets, national governments as well as the European Commission (EC) have recently emphasised that foreign takeovers of companies in the critical infrastructure sector will receive much greater scrutiny over the coming months.
While the responsibility for foreign direct investment (FDI) screenings lies with the Member States, on 25 March 2020 the EC issued Guidelines urging all Member States to be vigilant and use all tools available to protect European companies struggling with the economic effects caused by COVID-19 from foreign takeovers.

The Guidelines were issued in anticipation of the entry into force of the EU Regulation establishing a framework for the screening of FDI into the Union, which will be applicable from 11 October 2020. (See here for our alert on this Regulation). The FDI Screening Regulation does not establish a fully harmonised foreign investment regime in the EU, nor does it aim to replace the national foreign investment regimes of the different Member States. Instead, it seeks to promote best practices, cooperation and information sharing regarding foreign investment control between the EC and Member States.

The EC’s Guidelines – as well as related developments in a number of Member States (including all major economies, namely, Germany, France, Italy, and Spain) plus the UK – will of course be of particular relevance for healthcare-related businesses, but they also have the potential to affect other strategic industries to varying degrees.

2 Very High Risk: Core COVID-19 sectors under the spotlight

The EC’s Guidelines call on all Member States to make full use of their respective FDI screening mechanisms in order to protect key healthcare and research businesses – the resilience of these industries and their capacity to continue to respond to the needs of EU citizens is considered crucial in this crisis.

Furthermore the EC urges those Member States that currently do not have a screening mechanism (or whose rules do not cover all relevant transactions) "to set up a fully-fledged screening mechanism and in the meantime to use all other available options to address cases where the acquisition or control of a particular business, infrastructure or technology would create a risk to security or public order in the EU, including a risk to critical health infrastructures and supply of critical inputs."

Although only 14 Member States currently have national screening mechanisms for FDI, most of these countries already mandate investment control reviews for acquisitions of healthcare related activities by non-EU investors (e.g., Austria, France, Germany, Spain).

Moreover, Spain and Italy have recently tightened their respective FDI rules, ahead of the EC’s Guidance, to prevent certain foreign takeovers in light of the COVID-19 outbreak.

The Spanish government has enacted several emergency regulations to tackle the social and economic impact of the COVID-19 outbreak. One of these measures relates to its foreign investments screening mechanism, in particular the expansion of the pre-closing approval requirement. FDI in strategic sectors in Spain, including the health-related sector will now require prior approval from the Spanish government. In addition – and irrespective of
the sector - prior governmental approval will now be required for a certain
group of investors, including investors which already hold investments or are
active in the security, public policy or public health sector of another
Member State.

Italy has also announced plans to amend its tools to defend Italian
companies against takeovers by foreign investors, including a plan to
expand considerably the list of strategic activities. This may even lead to all
companies listed on the Milan Stock Exchange being considered as
strategic. Italy is also contemplating introducing measures to protect
companies in strategically important sectors and is reviewing its foreign
investment rules, the so-called “golden power rules”. A representative of the
Italian government has stated that the country is ready to apply a protective
shield to defend strategic Italian companies, using “any means necessary”. The Italian government intends, for instance, to extend its veto powers under
the golden power rules.

Further, the German government raised considerable concerns over the
rumoured offer by the US for German healthcare company Curevac, a
pioneer in mRNA therapeutics, an area which may be critical for the
treatment for COVID-19. However, the German government already has the
power to block such transactions by non-EU investors under the current
foreign investment regime and has been creative in the past in terms of
using state-owned bank KfW to acquire shareholdings in German companies
as a defence measure. The Federal Ministry of Economics has made very
clear over the past days and weeks that it stands ready to use this tool again
in the current situation.

We therefore expect intense scrutiny by the authorities – and an increased
risk – for any acquisition by foreign investors in the healthcare-related
sectors critical to the fight against the COVID-19 virus. In particular, the
activities related to the development and production of antiviral drugs,
medical equipment (e.g. respiratory equipment) may be protected
against hostile takeovers. These acquisitions are almost certain to face an
in-depth foreign investment screening, with a view to safeguarding critical
capacity in the European Union. The EC specifically called for Member
States to take into account not only the impact of proposed acquisitions on
national interests but also on the EU as a whole. Where investments are still
possible, it should be expected that relevant Member States will require
mitigation measures in the form of behavioural undertakings to protect
supplies in the relevant country, a tool which has become popular amongst
foreign investment regulators over the past two to three years.

The tightening of screening mechanisms will particularly affect new
transactions, but may also have an impact on ongoing reviews.

3 High Risk: Generally critical sectors
Whilst governments are primarily concerned about FDI in the healthcare
sector, they are also focussing on opportunistic takeovers of companies
suffering from the rout across the stock markets.

Therefore, we expect increased scrutiny in relation to these indirectly
affected transactions throughout Europe. This will mainly focus on generally
important companies, including critical infrastructure companies, key technology companies and national champions.

Moreover, FDI screening may be conducted in any sector which threatens security or public order. In this regard, the FDI Screening Regulation sets out a non-exhaustive list of sectors factors that Member States may take into account in their assessment.

The FDI Screening Regulation groups areas for concern into five categories: (i) critical infrastructure (physical or virtual, including utilities, health, transport, finance, communications, data, defence and aerospace, electoral and financial infrastructure, and real estate crucial to sensitive facilities); (ii) critical and strategic technologies (a wide-ranging sector, which includes artificial intelligence, nano/bio/quantum technologies, robotics, semiconductors, cybersecurity, energy storage, defence and dual-use items); (iii) critical inputs (commodities, raw materials, agriculture etc.); (iv) access or ability to control sensitive information (including personal health or large-scale sensitive data); and (v) media freedom and pluralism.

In line with the above, in December 2019, the French Government adopted a Decree extending the list of sectors which are subject to FDI review. (See here for our alert on this Decree) The Decree, which will apply to filings submitted as from 1 April 2020, extends the scope of the French FDI screening to the food safety, the press (including online press) and research and development related to quantum technologies and energy storage sectors. Moreover, the direct or indirect acquisition of more than 25% of shares or voting rights in French companies by non-EU/EEA investors (compared to 33.33% previously) will now be subject FDI screening. It should further be noted that the French Minister of Finance recently stated that “the French government is prepared to use all means to support big companies suffering in financial market turmoil, including nationalization if necessary”.

In Germany, we also expect special protection of the so-called Mittelstand, the backbone of the German industry. The key area of focus here is likely to be the protection against takeovers of undervalued companies in technology sectors, including inter alia companies active in the artificial intelligence, mechanical engineering and robotics (including 3D), biotechnology and quantum technology sectors. Moreover, Germany is in the process of further strengthening its foreign investment regime and issued a draft bill in January 2020. The amendments will in particular tighten the standard of review, with the threshold for the authority to take action being lowered to encompass all transactions “likely to affect public order or security in Germany”. It would not come as a surprise if progress on the bill was now to be accelerated.

In relation to the UK, the Government considers that the current rules which involve the secretary of state being able to intervene in transactions which fall within the merger control jurisdiction are ill-suited to deal with the national security risks that the UK faces. Under proposals put forward last year and still being considered, the intention is to be able to review all types of investments, in virtually any sector. It is unclear what form any reforms will
take, although it is considered fairly likely that any final legislation may be less comprehensive than the initial proposals (which anticipated reviewing up to 200 cases per year). However, not only are we seeing some uptick in cases being called in for review, but the Government has indicated it is already using the proposed reforms in relation to the nature of national security concerns as a template for its review of existing cases.

4 Medium Risk: Other sectors

It remains the case that there are still many sectors – such as standard industrial products – that are not generally considered sensitive from an economic and political view.

Even in these sectors, however, the potential for issues may nonetheless arise, for instance where the targets in question have access to information, including sensitive personal information of the citizens of the relevant jurisdiction. Equally, concerns have been raised in relation to the acquisition of land, or in cases where the assets being acquired were close to sensitive security installations.

Moreover, across many jurisdictions, the political climate has become much more hostile to foreign investment over recent years. Alongside a stronger focus on national self-interest and a greater scepticism about the benefits of globalisation, we have witnessed an increasing reluctance to accept foreign investment from jurisdictions which do not allow foreign investment on reciprocal terms.

As a result, it is more important than ever that companies engaged in M&A deals should

> consider the potential applicability of any foreign investment regimes at the planning stage and conduct a thorough risk assessment including understanding whether mitigation measures, if they were to be requested, interfere with the rationale for the transaction

> allow for a lengthier approvals process for their deal

> assess how best to mitigate any potential risks and/or delays associated with increased uncertainty and complexity of the review process

> consider how best to manage any overlaps with any relevant merger control filings