

# FDI screening: the new norm?

## SECURITY

THE TREND TOWARDS THE VETTING OF FOREIGN INVESTMENT, ESPECIALLY PROJECTS THAT INVOLVE ADVANCED TECHNOLOGY AND NATIONAL DATA OR POSE POTENTIAL SECURITY THREATS, IS ON THE RISE. DAVID GABATHULER AND MATTHEW T WEST GIVE A TRANS-ATLANTIC PERSPECTIVE

The vetting of FDI is becoming the new norm as more and more countries introduce foreign investment screening regimes or strengthen existing ones. Many of the changes are driven by increasing geopolitical and trade tensions and the realisation by governments that they potentially risk losing ownership and control of essential advanced technology and other strategic assets to strategic competitors.

In 2019, the OECD reported that nine out of the world's 10 largest economies have modified or introduced new policies to manage acquisition or ownership-related risks to essential security in the past two years. This trend will only accelerate as countries identify new or perceived threats to national security, societies become ever-more technology dependent, and vulnerabilities in the technology emerge.

### New regimes, tougher rules

The US and Europe have both embarked upon significant reforms in the area of foreign investment screening to ensure that they have a regime in place that can address new potential security threats.

The US introduced significant changes in August 2018 to the procedures and authorities by which the Committee on Foreign Investment in the United States (CFIUS) reviews foreign investment with regard to national security concerns. The



Illustration by John Holcroft

Foreign Investment Risk Review Modernization Act (Firmma) expands CFIUS's scope of review to transactions that were previously not within its mandate, including non-controlling investments in certain categories of US businesses and certain real estate transactions.

Firmma also amends CFIUS's review process to give certain parties the opportunity to have their proposed transactions reviewed and approved more expeditiously, while also requiring mandatory filings for other parties and transactions. Additionally, Firmma imposes several administrative changes to the CFIUS process. The US Department of the Treasury has now issued two sets of regulations that will comprehensively implement Firmma by February 13, 2020.

### European concerns

The EU has not had an extensive foreign investment screening

regime such as CFIUS and has largely limited its interventions to foreign investments affecting the defence industry and critical domestic infrastructures.

The situation has, however, changed dramatically in the past few years. European governments have become increasingly concerned that certain foreign investments in critical infrastructures and advanced technologies could weaken Europe's industrial leadership, economic cohesion and national security. The EU and its member states have, therefore, been rapidly introducing new FDI screening measures to address this perceived regulatory gap.

The most notable development was the adoption of a new EU framework for screening foreign investment in early 2019. The framework sets out common criteria and standards and provides a mechanism for the European Commission (EC) and

EU member states to co-operate in the vetting of foreign (non-EU) investment falling within the scope of the regulation. The EC principally has an advisory role and does not have the power to vet, let alone block, foreign investment; this power remains with member states, given the sensitivity of national security reviews.

The new EU framework is, nonetheless, expected to have a profound impact on FDI screening in Europe once it enters into full force in October 2020. Almost all member states are expected to introduce new vetting rules or strengthen existing ones, notwithstanding that there is no obligation under the EU regulation for them to put in place an FDI screening regime.

Many member states have already been strengthening their FDI screening regimes. In the past two years, France has extended the reach of its regime to more sectors (such as cybersecurity, AI and robotics) and granted the Ministry of the Economy wider powers on sanctions and enforcement. Germany lowered the threshold for intervention in 2017 to include more security-sensitive sectors and critical infrastructures within its FDI screening mechanism. The UK is expected to introduce widespread reforms to its regime during the new parliament. This trend is only likely to accelerate from 2020 onwards.

### National security threats

The increasing challenge for FDI screening regimes on both sides of the Atlantic will be to address new or perceived threats to national security.

Governments are increasingly prepared to intervene to ensure that domestic firms retain ownership and control of essential advanced technology, especially technology that has helped these firms achieve (or retain) industrial leadership. In July 2018, Germany effectively blocked a Chinese firm from acquiring Leifeld Metal Spinning, a company that produces high-specification metals for the aerospace and nuclear industries. In the US, Singapore-based Broadcom's \$117bn proposed takeover of Qualcomm, a leading US semiconductor and wireless technology producer, was blocked on national security grounds in March 2018.

The control of data, including personal data, is increasingly being

identified as having potentially strategic importance. In 2018, the US introduced reforms to cover investments related to, among other things, US companies that maintain or collect sensitive personal data of US citizens. The new EU framework specifically lists access to sensitive data, including personal, as a relevant factor to consider when reviewing investments on national security or public order grounds.

Threats to national security may, however, not simply relate to investments in well-established listed companies, since advanced technology may be developed by smaller start-up businesses whose implications for national security may yet not be well understood in government circles. In that vein, in 2018 the UK substantially lowered the thresholds that trigger investment screening in certain hi-tech sectors, particularly computing hardware design and production, and quantum technology.

### Likely trends in 2020

In both the US and Europe, the substantial strengthening of FDI screening is likely to lead to a significant increase in the number of transactions and investments that are vetted on national security and public interest grounds. Foreign investments in critical domestic infrastructure such as energy, telecoms and transport are likely to be increasingly subject to FDI screening, especially if the investments are made by state-owned enterprises.

Acquisitions of companies that maintain or collect sensitive personal data will also face increasing scrutiny, which could result in the rejection or unwinding of a transaction – as happened in 2019 when CFIUS ordered China-based Kunlun Group to divest its interest in dating app Grindr.

There is also expected to be increased screening in both the US and Europe of foreign investments in advanced technology sectors such as AI, robotics, manufacturing of semiconductors and quantum technology. Such foreign investments are likely to be very carefully scrutinised where the technology helps a country achieve or maintain industrial leadership or has dual-use capabilities.

CFIUS has already stopped transactions that involved the acquisition

  
[THE SCREENING] TREND  
WILL ONLY ACCELERATE AS  
COUNTRIES IDENTIFY NEW  
OR PERCEIVED THREATS  
TO NATIONAL SECURITY  


of advanced technology by foreign buyers, such as the blocking of Xcerra Corp's \$580m sale of its semiconductor testing business to a Chinese state-backed semiconductor investment fund.

National security risks are also increasingly being highlighted regarding arrangements that the OECD has termed "non-ownership transactions". This includes the lease of infrastructure used for government operations that grant access to sensitive assets or data associated with such assets, and government procurement contracts for the building or refurbishing of sensitive publicly owned assets. Added to this is heightened sensitivity (especially in the US) to the use of network equipment from certain third-country suppliers in important national infrastructures.

### Hazardous environment

Foreign investors will need to carefully evaluate whether their investments in 'sensitive sectors' risk triggering national security reviews, and they will have to become accustomed to an environment where potential FDI screening needs to be factored into deal-making.

In Europe, the emerging nature of many of the regimes and, like the US, the general lack of transparency in the screening process is likely to create considerable uncertainty, at least over the next few years, as companies and advisers become more accustomed to navigating their way through what is likely to be an intrinsically complex and opaque process. ■

See also the article on FDI screening on page 54.

David Gabathuler is legal consultant in the Brussels office of law firm Baker Botts, and Matthew T West is department chair, global projects, in the Washington, DC office. Matthew Levitt and Jason Wilcox also contributed to the article.