ALERTS

National Security Foreign Investment Regulation and COVID-19: Impact on CFIUS and Expanded Review by Australia, Canada, the European Union and Spain

April 28, 2020

Not surprisingly, the COVID-19 pandemic is affecting government review of foreign investment. In the United States, the Committee on Foreign Investment in the United States ("CFIUS") remains open and continues to review notified transactions, but the effect of staff working remotely is delaying the acceptance of new filings and will likely extend the period of time needed for the review of CFIUS declarations and notifications. The United States has not initiated any substantive changes in its foreign investment review laws or regulations in response to COVID-19, but presumably foreign acquisitions of U.S. health care technology and protective device manufacturers will be given greater scrutiny than they may have received prior to the current pandemic.

In contrast, a number of other countries are responding to the pandemic, and its economic effects on the valuation of companies, by tightening their foreign investment reporting requirements and requiring that transactions that previously were not subject to review now be subject to mandatory reporting and approval processes. In some cases, this merely accelerates the European Union's goal, announced last year, of having all member states adopt robust foreign investment screening laws by October of this year. In particular, Spain has expanded its foreign investment filing requirements and other EU member states may follow suit. Australia has also expanded filing requirements, while Canada has announced enforcement policy changes that would subject more transactions to stricter scrutiny.

These developments are discussed in further detail below.

The United States — CFIUS

On Feb. 13, 2020, the United States enacted final rules implementing the Foreign Investment Risk Review Modernization Act ("FIRRMA").[1] FIRRMA both expands CFIUS jurisdiction and codifies its recent practices. As a result of the new regulations, CFIUS now requires mandatory reporting of certain acquisitions of U.S. businesses by foreign investors and may, in other cases, initiate review of the national security implications of acquisitions of control by foreign investors of U.S. businesses, certain minority investments and real estate acquisitions. As was previously the case, if CFIUS finds a national security concern, it can seek mitigation, block a pending transaction or force divestiture of completed transactions. It now has the power to impose filing fees and civil penalties for non-filing.

Under CFIUS procedures, filing parties must submit a draft notification or report and wait for CFIUS staff to either accept the filing and begin the waiting period, or return the filing to the parties with a request that the filing be amended to include or clarify certain information. Only when CFIUS staff determines, in its sole discretion, that a filing is acceptable, does the formal review process and timetable begin.

As a result of the COVID-19 pandemic, many CFIUS personnel are working remotely, which means that they do not have access to classified government computer systems necessary for elements of their review. CFIUS staff includes members of the U.S.-intelligence community who support the threat-assessment process. These personnel must work in a security-cleared government office or through secure communications systems.

CFIUS practitioners are reporting that staff is taking longer than usual to accept new CFIUS filings, although it seems to be continuing to process and resolve CFIUS filings made prior to the pandemic. Going forward, it is anticipated that, in addition to delays in acceptance, more CFIUS investigations will be extended into a second 45-day stage in order to provide staff additional review time. Further, for mandatory declarations, more transactions may receive a "no-action" response rather than a formal clearance in to order both expedite review and preserve CFIUS's ability to investigate more fully, and potentially challenge, closed transactions after the pandemic no longer limits its investigative resources.

Australia

Australia's foreign investment reporting system is one of the strictest among developed countries. The Foreign Acquisitions and Takeovers Act 1975 ("FATA") requires reporting to the Australian Foreign Investment Review Board ("FIRB") of an investment by a foreign entity if certain dollar threshold tests are met by the acquired Australian business. Some of the local asset thresholds for reporting are set at zero dollars, although there are also a number of exemptions that may apply.

On March 29, 2020, the Australian Treasurer announced changes designed to help safeguard Australia's national interest in response to the coronavirus outbreak. According to the regulations published on April 16, 2020[2]:

- Now **all** proposed foreign investments in Australian businesses that are subject to FATA will require government approval, regardless of the value or the nature of the foreign investment. This change is implemented by reducing the monetary screening thresholds for all foreign investments to zero dollars; and
- The Australian FIRB will seek to extend the review periods for all existing and new applications for foreign investment approval from the current statutory 30 day period to up to six months.

On April 24, the Australian government issued Guidance Note 53 further explaining the changes.[3] It has also indicated that it "will prioritise urgent applications for investments that protect and support Australian business and Australian jobs."[4]

Canada

On April 18, 2020, the Canadian Minister of Innovation, Science and Industry issued a policy statement declaring that it will subject certain investments by non-Canadian investors to enhanced scrutiny under the Investment Canada Act ("ICA").[5] The enhanced review applies to investments in Canadian businesses related to "public health" or "critical goods and services.” The reasons given for this stricter review include the declines in value of Canadian businesses and the now-recognized importance of goods and services essential during the COVID-19 pandemic.

Importantly, the new policy does not expand the types of transactions that are subject to mandatory notice under the ICA. Indirect acquisitions of control of Canadian businesses remain excluded from prior approval requirements and will continue to require the filing of a simple post-closing notice. Direct acquisitions of Canadian businesses remain subject to the current thresholds for mandatory filing.

The new policy is likely to result in more thorough review of ICA-notified transactions, and an increase in the number of investigations of non-notifiable transactions initiated under the government’s rights under the ICA to order a national security review of transactions within 45 days after closing, particularly acquisitions of Canadian businesses by state owned enterprises and those involving health care and critical goods and services.

European Union

On March 25, 2020, the European Commission issued guidelines “to ensure a strong EU-wide approach to foreign investment screening in a time of public health crisis and related economic vulnerability. The aim is to preserve EU companies and critical assets, notably in areas such as health, medical research, biotechnology and infrastructures that are essential for … security and public order.”[6] In the announcement, EU Commissioner for Trade Phil Hogan said:

“We are facing an unprecedented public health crisis with deep consequences for the European economy … In the current circumstances, we … need to know who invests and for what purpose. The EU and its member states have the right legal tools for that. Today’s guidelines call upon member states to use these tools to the fullest extent and will bring additional clarity on how to use our investment screening framework to prevent a sell-off of strategic EU assets in the current crisis.” [*Id.*]

The EU does not itself regulate foreign investment, but leaves such review to its member states, 14 of which currently have foreign investment screening mechanisms in place. Under existing EU rules, member states are empowered to screen foreign direct investment from non-EU countries on grounds of security and public order. Protection of public health is recognized as an overriding reason in the general interest. As a result, member states can impose mitigating measures (such as supply commitments to meet national and EU vital needs) or prevent a foreign investor from acquiring or taking control over a company. [*Id.*]

The EU foreign direct investment screening regulation was adopted in March 2019.[7] It creates an EU-level mechanism to coordinate the screening of foreign investment with its member states. This mechanism will commence Oct. 11, 2020 and may allow for the Commission and member states to issue opinions and comments on specific transactions.

The new Guidelines call on the remaining member states that do not as yet have full screening mechanisms to implement them as promptly as practicable in advance of the October 2020 deadline. Member states are at various stages in the process. France's new foreign investment review system, which was developed prior to the pandemic, became operative on April 1, 2020. There have been no changes directly related to the pandemic, though it is certain to be a consideration as investments in French businesses are reviewed. On April 23, 2020, the German government held the first reading of a draft bill to amend the German Foreign Trade Act with respect to regulating foreign investment, and its final provisions will presumably will be shaped by the current environment.

Spain

On March 17, 2020, the Spanish government approved tightening its regulation of foreign investment under Royal Decree Law 8/2020.[8] This law adds additional reporting obligations to Spain's existing foreign investment regime. The new rules apply to non-EU/EFTA investors acquiring in excess of 10% or obtaining certain participation in the management of a Spanish company in certain strategic sectors. These strategic sectors mirror those in the U.S. FIRRMA legislation, and include critical technology, critical infrastructure and sensitive personal data.

Under the new rules, prior approval will also be required for any 10% or greater investment or management control in a Spanish company in any sector (i.e., not limited strategic sectors) by (a) a foreign government, including sovereign wealth funds; (b) foreign investors who have already invested in security, public health or public policy sectors in any other EU member state; and (c) foreign investors subject to administrative or judicial proceedings anywhere in the world for engaging in criminal or illegal activities. The new law states that if the proposed investment is not approved within six months, then it is considered prohibited.

Spanish counsel have pointed out that this is an entirely new area of regulation, and many of the law's terms remain vague and undefined. They will require clarification in order to enable parties to determine whether a particular transaction will require approval by the Spanish authorities prior to implementation.

The Spanish government justifies this increased screening by reference to the COVID-19 pandemic and concerns that decreases in Spanish company valuations may result in foreign investors taking advantage of undervalued Spanish companies, as well as Spain's desire to comply with the October 2020 EU framework for the screening of foreign investments.

Conclusion

The COVID-19 pandemic has strained government regulators around the world, and the United States is no exception. CFIUS continues to work to review notified transactions but is likely to experience more delays as the pandemic continues.

Around the world, the COVID-19 pandemic may accelerate the prior trend of tightening national regulation of inward foreign investment. In particular, several governments have expressed concern that the economic effects of the pandemic may result in acquisitions of local businesses by foreign investors at depressed values that may harm their national interest. Some governments have responded quickly to this concern, with new regulations being issued with little or no advance warning, although generally the new rules have not been applied to transactions that had already been signed but not closed as of the announcement date. Other countries are likely to follow suit with procedural reporting and policy changes in addressing similar concerns in the coming weeks and months.

Parties negotiating or contemplating cross-border transactions will need to remain vigilant and consult with foreign investment law specialists to carefully monitor the evolving foreign investment regulatory environment during the coming months.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] 85 FR 3112 (Jan. 17, 2020); and Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), Subtitle A of Title XVII of Public Law 115–232 (Aug. 13, 2018).

[2] Foreign Acquisitions and Takeovers Amendment (Threshold Test) Regulations 2020, available here (April 16, 2020).

[3] Guidance Note 53: Temporary measures in response to the coronavirus, available here (April 24, 2020).

[4] Q&A — Temporary changes to foreign investment framework, available here (April 17, 2020).

[5] Government of Canada, Policy Statement on Foreign Investment Review and COVID-19, available here (April 18, 2020).

[6] Press Release, Coronavirus: Commission issues guidelines to protect critical European assets and technology in current crisis, available here.

[7] Regulation (EU) 2019/452 of the European Parliament and of the Council as of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, available here.

[8] Real Decreto-ley 8/2020, de 17 de marzo, de medidas urgentes extraordinarias para hacer frente al impacto económico y social del COVID-19, available here.

This is a fast-moving topic and the information contained in this Alert is current as of the date it was published.

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