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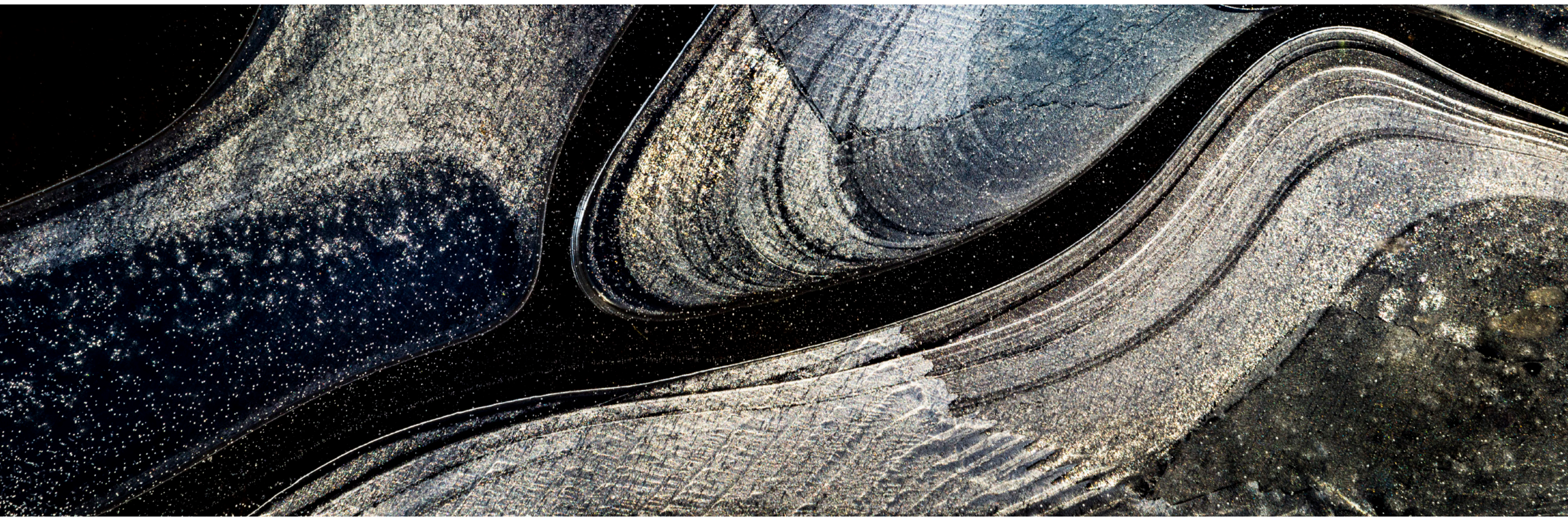


M&A Standpoint

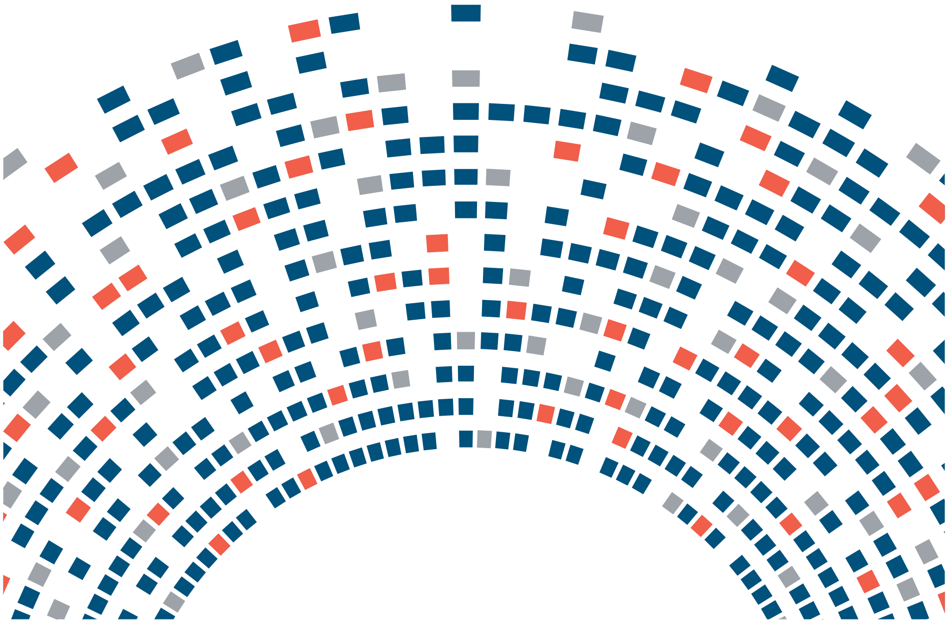
Political intervention in M&A: Is the tide turning?

Political intervention in cross-border acquisitions is on the increase globally, against a back-drop of protectionist rhetoric in some countries: the blocking by President Trump of the bid by China-backed Canyon Bridge for Lattice Semiconductor being the latest high-profile example. Jurisdictions traditionally reluctant to intervene on national interest grounds have expanded the scope of their foreign investment regimes and, in some cases, have started to block deals or extract strict conditions for clearance. When planning a deal, foreign direct investment (FDI) regimes need to be considered alongside competition based merger control rules, but governments tend to have much broader discretionary powers to intervene on the FDI front.

The OECD has compiled a Regulatory Restrictiveness Index plotting the scope of FDI regimes in over 60 countries on a sliding scale. This shows that EU countries collectively have the fewest restrictions on FDI. However, the EU has recently announced plans to introduce a framework for its Member States to operate foreign investment regimes on security or public order grounds: Member States will not be obliged to introduce new rules but, if they do, they must follow the broad framework and will also benefit from a co-operation and information sharing arrangement with other Member States and the European Commission. It remains to be seen how this will fare through the EU legislative process, given the sharp disagreements between Member States on this issue.

At the same time we have seen a reverse trend elsewhere. The OECD's Index shows that the biggest reformers in the last 20 years have all been in Asia. Countries such as South Korea, Vietnam and the Philippines have seen a significant inflow of foreign investment at least partly as a result. We continue to see reforms of the traditionally most restrictive regimes: India and China liberalised their FDI rules last year.

Why is it, in this context, that we are seeing traditionally more liberal countries start to flex their interventionist muscles more?



UK tempers free movement of capital

One of Theresa May's first acts as UK Prime Minister was to announce a review of the build contract for the Hinkley Point C nuclear power station, amid security concerns given Chinese involvement. This marked a significant departure from previous Conservative policy. After several high-profile deals involving foreign acquirers of 'national champions' – the Kraft takeover of Cadbury, Pfizer's unsuccessful hostile takeover bid for AstraZeneca, and more recently Softbank's acquisition of British microchip maker ARM – protectionist rhetoric has intensified in the UK.

Scarred by Kraft's perceived reneging on a key deal promise, the UK bolstered its takeover regime with measures such as a limit on the time bidders had to formally launch an offer and to make parties stand by promises often made around "softer" (mainly employment) issues. Despite recent measures, the UK regime remains grounded in an objective, competition-based legal framework with intervention on the basis of national interest limited to a small number of sectors (national security, media plurality and stability of the UK's financial system).

But is this set to change? The Conservative's 2017 manifesto made clear it will reform takeover rules. It set out three main proposals - requiring bidders to make their intentions clear from the outset of a bid, making promises made in the course of bids legally enforceable, and allowing government to freeze bids to allow greater scrutiny. The manifesto cites the protection of critical national infrastructure, mentioning telecoms, defence and energy.

The UK Takeover Panel has since published a consultation paper on statements of intention under the Takeover Code and the government has recently launched a consultation on the scope of proposals to address national security concerns in foreign investment. What is considered "critical national infrastructure" and which national champions government will seek to protect remains to be seen.

How far the government can go with its proposals will depend on the shape of Brexit. If the UK-EU relationship falls outside of the existing EU regime, or if no divorce deal is agreed, the UK will be open to set its own restrictions on all foreign investors. The more challenging constraint is likely to be a practical one however - balancing increased state intervention with the mantra that Britain is open for business post-Brexit.

2017 M&A deal flows suggest the potential for public interest interventionism has not dampened M&A activity. One thing is clear – foreign investors in the UK and their advisers should expect, and plan for, increased political and media scrutiny.

'America First' – will M&A suffer?

While the UK is focused on securing new international trade deals, the Trump administration has set about unpicking several of America's international trade agreements and threatened punitive tariffs on importing manufacturers. Popular tax inversion deal structures have also been targeted with proposals to cut corporation tax rates and scale back taxation of companies' non-US earnings.

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This raises the question of whether President Trump's protectionist agenda will impact deal activity. There have been a number of recent reviews by CFIUS (Committee on Foreign Investments in the US), particularly relating to Chinese acquirers. As well as the Lattice Semiconductor blocked deal mentioned above, several other Chinese investments have been referred to CFIUS in recent months. However, this is not a new trend - the number of CFIUS reviews increased by 40% under the Obama administration compared to the previous administration.

So far, M&A activity remains buoyant – with the number of announced North America M&A deals in 2017 predicted to increase by approximately 10% year on year. President Trump's proposed tax and regulatory changes may well prove to be a boon for M&A activity – provided that acquirers are prepared to weather political uncertainty and potential CFIUS scrutiny.

Navigating FDI

In most countries, the national interests at stake are the same: defence, critical infrastructure (energy, transport, communications, data storage, financial infrastructure, sensitive facilities), access to sensitive information and employment. And more assets are being added to the list, most recently critical technologies, which the European Commission has defined broadly to include semiconductors, AI, robotics, cybersecurity, space and nuclear. This is seen by many commentators as a reaction to mainly Chinese attempts to buy up key European IP assets (for example, the takeover of KUKA by Midea).

Sometimes it will be obvious that a deal might have an impact in one of these areas. But there will always be an element of unpredictability: in previous cases the Australian government blocked the acquisition of a grain handling company and the French government has objected to the acquisition of yoghurt company, Danone.

So, what does this all mean for deal planning? The way many of the regimes work in practice can make it difficult to predict with any certainty how - or at what stage - a government will react to a particular deal.

The FDI decision-makers do not publish decisions explaining non-interventions. Even where a deal is prohibited or conditions imposed, the underlying rationale is not always clear; for example CFIUS does not publish any decisions or opinions. The appeal process for those who do have the appetite to challenge unwelcome decisions can be so lengthy that the deal opportunity is missed in the meantime. Some FDI regimes even allow governments to intervene in deals post-completion.

This makes the FDI process very different to merger control, where independent competition authorities publish reasoned decisions, companies usually have to wait until they receive merger clearance before completing a deal, and fixed timetables apply. The emphasis in the EU FDI proposals on transparency, judicial review, and process is therefore welcome.

An additional complication is the potential for inter-governmental pressure, such as when the US successfully persuaded the German government to withdraw its earlier approval for the acquisition of chip equipment maker Aixtron by Fujian Grand Chip Investment Fund, because Aixtron's chips could be used in nuclear technology.

The key to resolving at least some of this uncertainty is to plan the global regulatory and communications strategy around the transaction from the outset. Track the general trends in FDI outcomes across the different regimes and make early contact with the relevant authorities. Some of the reported cases show that taking the time to explain the impact and proposed structure of a transaction to the FDI authorities can make a difference. Where time is of the essence, it may be possible to structure transactions so that the deal can go ahead and parts of the target are held separate in those countries where the FDI regime could apply and more time is needed.

Of course, there are likely to be cases where political interests end up being the decisive factor: the current US administration's focus on "America First" is one example of this. We may well end up also seeing some "tit for tat" decisions between the different FDI regimes. But hopefully this will remain the exception rather than the norm.

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