

National security reviews: A global perspective

A guide to navigating the rules for investing in countries that require national security approval





Navigating national security reviews worldwide

As national security reviews of foreign investments grow more prevalent, knowing the rules can help you prepare for any outcome

Governments worldwide are focusing greater scrutiny on foreign direct investments into their countries. In particular, they are subjecting an increasing number of cross-border transactions to national security reviews to ensure that the purchase of a domestic asset by a foreign investor does not jeopardize their national security. Depending on the jurisdiction, a national security review and its outcome can significantly impact a transaction, including changes in the terms of the deal or its outright termination.

Every country that conducts national security reviews assigns that responsibility to a particular government component, such as the Committee on Foreign Investment in the United States (commonly known as CFIUS), the Chinese Ministry of Commerce, or the German Federal Ministry for Economic Affairs and Energy.

The types of transactions subject to review and the scope of review vary widely from country to country. Some countries, for instance, publish a list of industries in which a national security review for a foreign investment transaction is likely to be triggered. China has a list of 57 industries, while Russia lists 45 activities of “strategic importance.” Others have more general standards: the United States allows CFIUS to conduct national security reviews of any transaction that could result in control of a US business by a foreign person, without defining “national security”—giving CFIUS substantial leeway to review transactions covering a wide variety of areas. Some countries subject very specific types of transactions to review. Australia, for example, requires approval for any foreign investor’s acquisition of residential land, vacant land, or any land for redevelopment.

Most national security reviews generally have three possible outcomes: The transaction may be approved; the transaction may be approved subject to certain conditions designed to mitigate national security concerns; or the transaction may be blocked/unwound. Mitigation conditions can range widely, but they commonly involve segregation or divestiture of sensitive businesses, governance requirements, or assurances of continuation of important activities.

Given the enormous impact a national security review can have on a transaction, it is essential for cross-border investors to know in detail each country’s requirements and to structure the transaction so as to address any risk arising from the reviews. This requires careful consideration of national security issues in planning and negotiating transactions, including the allocation of national security review-related risk in the transaction documents.

This report outlines the national security review landscape in six countries—the United States, China, Russia, Germany, France and Australia. For each country it details who conducts national security reviews, who must file, the types of deals reviewed, the scope of the review, the possible outcomes, trends in the review process, how foreign investors can protect themselves and the review process timeline. It also provides investors with general suggestions on the structuring and documentation of their transactions to reduce national security review-related risks.



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United States

Deals are generally approved, but a wide range of mitigation conditions may be imposed that can have a significant impact

The Committee on Foreign Investment in the United States (CFIUS), which is led by the US Department of the Treasury and made up of US national security and economic agencies, including Defense, State, Justice, Commerce, Energy and Homeland Security, reviews acquisitions of US businesses by foreign persons or businesses.

WHO FILES

The parties to the acquisition file a joint voluntary notice with attachments that include annual reports, the deal document and information about the target's US government contracts (if any). A CFIUS review is ostensibly a voluntary process, but in some cases it is effectively mandatory, e.g., acquisitions of cleared defense contractors or assets likely to qualify as critical infrastructure.

CFIUS actively looks for transactions of interest that were not notified and will "invite" parties to submit a filing regarding transactions it would like to review.

TYPES OF DEALS REVIEWED

CFIUS has jurisdiction to review any transaction that could result in control of a US business by a foreign person. "Control" is defined broadly and can include many minority investments. The types of transactions that CFIUS can review are quite varied, including deals structured as stock or asset purchases, debt-to-equity conversions, foreign-foreign transactions where the target has US assets, private equity investments, and joint ventures where the foreign partner is investing in an acquired or contributed US business.

Unlike the French and Chinese national security regimes, the CFIUS statute does not specify what types of industries are relevant to national security. This has given CFIUS substantial leeway to review transactions covering a wide variety of areas, including identity authentication, biometrics, information technology, energy, telecommunications, food safety, financial services, real estate, cyber

security and healthcare, as well as industries with a more direct link to national security such as aerospace and defense. External issues unrelated to the structure of the transaction, such as the US business's location in close proximity to sensitive US government assets, can also pose substantial national security concerns.

Accordingly, it is important to consider CFIUS issues in connection with any transaction involving foreign investment (direct or indirect) in a US business with a potential link to US national security.



In recent years, there has been a significant broadening of the foreign investor base represented in CFIUS reviews, with greater activity from emerging markets.

SCOPE OF THE REVIEW

The CFIUS review process is designed to assess the risk profile of the deal from a US national security perspective. It analyzes the threat posed by the foreign buyer, the vulnerability exposed by the target, and the consequences exposed by the threat and vulnerability put together. Based on that risk profile, CFIUS decides if the deal can proceed with or without mitigation, or whether it needs to be stopped. Often the analysis is done based on the filing with follow-up Q&A. Sometimes the parties will also meet with CFIUS either per the parties' or CFIUS' request.

TRENDS IN THE REVIEW PROCESS

In recent years, there has been a significant broadening of the foreign investor base represented in CFIUS reviews, with greater activity from emerging markets, such as China, Japan, India and the Middle East, and relatively less participation by more traditional European and Canadian investors. As a result, the risk factors CFIUS considers in its national security analysis have changed to reflect a broader pool of investors.

HOW FOREIGN INVESTORS CAN PROTECT THEMSELVES

It is critical for foreign investors to consider CFIUS issues in planning and negotiating transactions, including with respect to allocation of CFIUS-related risk. The range of mitigation requirements that can be imposed is quite wide (based on the risk profile of the deal), and it is important for buyers in particular to have as clear an understanding as possible with respect to what mitigation requirements would be acceptable to them. As a buyer, you do not want to buy an asset and have CFIUS-imposed mitigation prevent you from achieving your objectives for the deal.

OUTCOMES

- The vast majority of deals are approved.
- Where CFIUS has national security concerns, it can impose mitigation conditions that can have significant implications on the foreign investor's involvement with the US business or even ultimately lead to the need to divest the asset.
- A small but notable number of deals are abandoned while going through the process. For example, a Chinese consortium's planned US\$2.8 billion acquisition of Royal Philips NV's Lumileds business unit was abandoned due to concerns CFIUS raised about the transaction.
- Only the US President can formally stop a deal, which has happened twice in the history of CFIUS. CFIUS can, however, suggest that parties abandon a deal, or it will recommend a block, at which point parties usually agree to withdraw from the transaction.

REVIEW PROCESS TIMELINE

The process can often take up to three months from the time the parties submit the joint voluntary notice and its attachments to CFIUS in draft (called a prefilling) to completion. CFIUS typically takes about two weeks to review and comment on the prefilling. Thereafter, once the parties incorporate CFIUS' comments and formally file, CFIUS typically takes a few days to accept the filing and start a 30 calendar-day review process. At the end of the 30 calendar days, the review is either completed or is taken to the investigation phase (which happens in about 40 percent of all filed cases annually). Investigation can take up to 45 calendar days. Thereafter, most reviews are completed. On rare occasions, contentious deals are taken to the President for a decision, who has 15 days to decide. Sometimes, most often when parties are negotiating mitigation terms with CFIUS, and the terms have not been agreed upon at the end of the investigation phase, CFIUS may encourage the parties to withdraw and resubmit the notice to restart the 30-day clock.

China

China is attempting to implement a more structured and comprehensive system to keep a closer eye on economic deals that might have security implications

A ministerial review panel established by China's Ministry of Commerce (MOFCOM) pursuant to a rule issued by the State Council in 2011 (the 2011 Rule) is responsible for conducting national security reviews of foreign investments in domestic enterprises.

In addition to the 2011 Rule, China is in the process of implementing a comprehensive set of rules and regulations governing national security reviews for foreign investments. On July 1, 2015, China promulgated the new PRC National Security Law (the NSL), which is China's most comprehensive set of national security legislation to date. However, the NSL's main provisions do not detail how these security measures will be implemented by the relevant agencies and local authorities. As such, the NSL's full impact on individuals and corporations in the private sector will remain unclear until relevant implementation measures are issued.

WHO FILES

According to the 2011 Rule, MOFCOM reviews foreign-investment transactions following voluntary filings by the parties

to the transaction, referrals from other governmental agencies, or reports from third parties.

Under China's current regulatory system, a national security review filing applies only to mergers and acquisitions involving Chinese companies and foreign investors under circumstances provided under the 2011 Rule. The 2011 Rule prescribes that a foreign investor must apply for a national security review if the investor acquires equity in, and/or assets of, a domestic enterprise in China. In contrast, a transaction between two foreign parties involving interests in Chinese companies is not subject to the national security review requirement.

TYPES OF DEALS REVIEWED

MOFCOM published a list of 57 industries in which a national security review for a foreign investment transaction is likely to be triggered. These industries mainly include military or military-related products or services, national defense-related products or services, agricultural products, energy, resources, infrastructure, significant transportation services, key technology and heavy equipment manufacturing.



Foreign investors should continue to be mindful of the terms and conditions of the 2011 Rule and pay special attention to transactions that might fall within the 57 industries that are likelier to trigger national security concerns.

SCOPE OF THE REVIEW

The scope of review focuses on the overall risk profile and impact that various M&A transactions may have on China's national security, defense, economy and public interest.

Foreign investors targeting assets in free trade zones are subject to more stringent national security review rules. The ministerial review panel has wider discretion to terminate or restrict foreign investment transactions in these zones because, while the 2011 Rule gives the panel authority to review foreign investors that obtain "actual control" over companies in the industries listed above, rules governing free trade zones indicate that the panel is allowed also to regulate any foreign investor that has a "significant impact" on investees within the industries listed above.

Greenfield investments and investments in cultural and internet businesses established within these free trade zones through offshore and other contractual arrangements are also subject to national security reviews.

TRENDS IN THE REVIEW PROCESS

The NSL's promulgation indicates that China is attempting to implement a more structured and comprehensive system to keep a closer eye on economic deals that might have security implications. As of now, it is unclear what direction China's national security review will take due to the lack of implementation measures for the NSL.

Also, as part of China's overall national security initiative, China is in the process of issuing the Cybersecurity Law and issued a second draft of the law in July 2016 (the CSL). The CSL primarily focuses on data security protection requirements and standards for critical information infrastructure operators, network operators and financial institutions.

Other propositions include security review for operators that seek to purchase network products and services that may influence national security.

In light of the NSL and the proposed CSL, foreign investors should continue to monitor the developments of China's national security review process in the future.

HOW FOREIGN INVESTORS CAN PROTECT THEMSELVES

Until issuance of implementation rules to the NSL, foreign investors should continue to be mindful of the terms and conditions of the 2011 Rule and pay special attention to transactions that might fall within the 57 industries that are likelier to trigger national security concerns for MOFCOM. Buyers should also be cautious when completing transactions before obtaining a national security approval, since buyers might be forced to divest the acquired assets if the transaction ultimately fails the security approval process. Due to enforcement uncertainties and the broad scope of captured industries, foreign investors interested in sensitive industries often schedule voluntary meetings with MOFCOM officials to determine the national security review risk before commencing the formal application process.

REVIEW PROCESS TIMELINE

The timeline used in practice and details of the national security review process in China are unclear, as information related to each individual application is not publicly available. The notional timeline below is based on the 2011 Rule:

MOFCOM will submit an application to a ministerial panel for review within five working days, if the application falls within the scope of review.

The panel will then solicit written opinions from relevant departments to assess the security impact of the transaction. It could take up to 30 working days to complete the general review process.

The panel will then conduct a special review of the application if any written opinion states that the transaction may have security implications and will conduct a more detailed security assessment of the overall impact of the transaction. A final decision from the review panel will be issued within 60 working days of the start of the special review.

OUTCOMES

Generally, the outcomes of a national security review are as follows:

- The investment may be approved by MOFCOM, including with mitigation conditions.
- MOFCOM will terminate a foreign investment project if it fails the national security review.
- If the Chinese government has national security concerns about a transaction that is not submitted for approval, parties could be subject to sanctions or mitigation measures, including a requirement to divest the acquired Chinese assets.
- A foreign investor may withdraw its application for national security review only with MOFCOM's prior consent.
- Decisions resulting from a national security review may not be administratively reconsidered or litigated.



France

Following the Montebourg Decree in 2014, the scope of activities covered by national security reviews has been significantly extended to several key industries

The Bureau Multicom 2, which is located within the Ministry of Economy's (MoE) Treasury Department, conducts the review. The process generally involves other relevant ministries and administrations depending on the areas at stake. Since January 2016, a commissioner of strategic information and economic security (attached to the MoE) also assists the Treasury when coordinating inter-ministerial consultations.

WHO FILES

The foreign investor files a mandatory request for prior authorization, which must include detailed information on the investor and its shareholders, the target, the pre- and post-closing structures, financial terms of the transaction and the sensitive activities at stake.

TYPES OF DEALS REVIEWED

Transactions reviewed under the French Monetary and Financial Code (MFC) include:

- Direct or indirect acquisition by a foreign investor of an undertaking whose registered office is established in France

- Direct or indirect acquisition by a foreign investor of all or part of a branch of activity of an undertaking whose registered office is established in France
- For non-EU investors only, acquisition of more than 33.33 percent in the capital or voting rights of an undertaking whose registered office is established in France

French law does not provide for any materiality threshold—even transactions of modest size can be captured for review.

The review only applies to foreign investments made in sensitive activities listed in the code. For EU-based investors, these activities include defense and security-related activities and dual-use technologies. For non-EU investors, additional activities are captured (e.g., gambling).

The activities reviewed under the MFC were expanded pursuant to a decree issued in May 2014 (the Montebourg Decree), which applies to both EU and non-EU investors. The Montebourg Decree significantly extended the scope of reviewable activities to "activities



French law does not provide for any materiality threshold—even transactions of modest size can be captured for review.

relating to equipment, products or services, including those relating to safety and the proper functioning of facilities and equipment, essential to guarantee the French national interests in terms of public policy, public security or national defense" in the following sectors: electricity, gas, oil or other source of energy; water supply; transportation networks and services; electronic communication networks and services; an installation, facility or structure of vital importance; and protection of the public health.

SCOPE OF THE REVIEW

MoE assesses whether the transaction may jeopardize public order, public safety or national security based on the information the investor provided in its submission. Follow-up Q&A and meetings with MoE and other ministries involved are customary. The seller may also be requested to cooperate with the review.

TRENDS IN THE REVIEW PROCESS

Following the Montebourg Decree, the scope of covered activities has been significantly extended to several key industries, including the manufacturing of sensitive information technologies, related products or network industries. Any transaction involving the foreign acquisition of a French business

in one of the specified industries should be carefully screened to assess if prior authorization is required. Involvement of other interested ministries in the process has also become customary.

HOW FOREIGN INVESTORS CAN PROTECT THEMSELVES

It is critical for foreign investors to anticipate foreign investment control issues ahead of planning and negotiating transactions. The responsibility for filing lies primarily on the buyer and, if the transaction falls under MFC regulation, prior clearance by MoE should be a condition of the deal. The buyer may also seek a ruling from MoE to confirm whether a contemplated transaction falls within the scope of the MFC.

The seller's cooperation in the preparation and review of the filing is important. If the parties expect that conditions or undertakings will be imposed, the buyer should anticipate discussions with MoE and other interested ministries that may impact the timeline for clearance. In addition, the buyer should consider including a break-up fee or opt-out clause in the transaction documentation to protect its interests if the conditions imposed on the transaction are too burdensome. Preliminary informal contacts with French authorities may also be advisable.

REVIEW PROCESS TIMELINE

MoE must make its decision within two months of its receipt of a complete authorization request. Longer periods (e.g., three or four months) should be anticipated if MoE requests supplemental information and considers imposing conditions to clear the case.

OUTCOMES

Once the review is completed, the MoE may:

- Authorize the transaction without condition (rather rare)
- Authorize the transaction subject to mitigating conditions/undertakings aimed at ensuring that the transaction will not adversely affect public order, public safety or national security (most of the cases when the MoE decides to review the investment)
- Refuse to authorize the transaction if adverse effects cannot be remedied (very rare)

Mitigating conditions/undertakings may pertain to the investor's preservation of the continuity of the target's activities and the security of its supply of products or services (for example, maintaining existing contracts with public entities, maintaining R&D capabilities and production in France). They may also include corporate requirements such as ensuring that sensitive activities are carried out by a French legal entity, and/or imposing information-access/governance requirements involving French authorities.

MoE review is a mandatory process. If a transaction subject to review is closed without MoE's prior approval, MoE may order the investor(s) not to proceed with the transaction, to amend the terms of the transaction or to unwind the transaction at their own expense, (potentially imposing a financial penalty of up to twice the amount of the original investment). Moreover, contractual agreements in breach of the mandatory process are deemed null and void. Violation of foreign investment rules may also give rise to criminal sanctions of up to five years of imprisonment and a fine of up to twice the amount of the investment.

Germany

Trend towards higher scrutiny of inbound transactions by the Federal Ministry for Economic Affairs and Energy

Generally, German law provides for a liberal investment climate and only very limited restrictions on foreign investments. However, the Federal Ministry for Economic Affairs and Energy (the “Ministry”) may prohibit or restrict certain foreign investments pursuant to the Foreign Trade and Payments Act (*Außenwirtschaftsgesetz* — “AWG”) and the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung* — “AWV”). The latter entitle the Ministry to review acquisitions by foreign investors based outside the European Union (EU) or the European Free Trade Association (EFTA).

Such review includes a general, non-sector-related prohibition right (“catch-all”) if the acquisition endangers “public order or security” (*öffentliche Ordnung oder Sicherheit*) of the Federal Republic of Germany. In addition, foreign investments in certain sectors like defense and IT security are subject to mandatory notification.

WHO FILES

Although the AWG/AWV review is not mandatory for all acquisitions, as a matter of best practice foreign investors will often initiate a review process as a precautionary measure by asking the Ministry for a non-objection certificate (*Unbedenklichkeitsbescheinigung*) to ascertain if the transaction could reasonably affect public order or security. If the target company is active in one of the sensitive sectors (defense and IT security), a notification to the Ministry by the direct acquirer is mandatory.

TYPES OF DEALS REVIEWED

Acquisitions of German companies (via asset or share deal) by non-EU-based investors or acquisitions of a direct or indirect stake in a domestic company, after which the direct or indirect share of the acquirer’s voting rights in the domestic company reaches or exceeds 25 percent, can be subject to review. The calculation of voting rights must take into account any agreement on the joint exercise of voting rights.



To avoid any security risks, the Federal Ministry for Economic Affairs and Energy may review the acquisition of domestic companies by foreign buyers in individual cases (*cited from the website of the Ministry*).

EFTA-based investors (Iceland, Liechtenstein, Norway and Switzerland) are treated the same way as EU-based investors. The Ministry is also entitled to review transactions involving an EU-based investor in which non-EU-based investors hold (directly or indirectly) at least 25 percent of the voting rights, if there are indications of circumvention of foreign investment control (e.g., if the EU-based acquirer is a mere acquisition vehicle without any entrepreneurial activities).

The sector-specific review mentioned above applies to all non-German investors in contrast to the general review process, which only applies to non-EU/EFTA-based investors.

SCOPE OF THE REVIEW

The Ministry may object to or restrict an acquisition if it threatens public order or security. Public security concerns the functioning of the state and its institutions, i.e., safeguarding the state's existence in the face of internal and external influences. The review is not limited to specific sectors. The Court of Justice of the European Union has expressly recognized the relevance of public security to safeguarding telecommunications and electricity services at times of crisis or safeguarding services that are of strategic importance. Additionally, pursuant to one of the most important principles of administrative law, any decision to prohibit or limit the acquisition can only be justified

on the grounds of public order or security if it is proportionate.

Any Ministry decision may be challenged before a German court.

TRENDS IN THE REVIEW PROCESS

Although the foreign investment review process is not publicly accessible, recent acquisitions have shown that the Ministry has become more sensitive about acquisitions by non-EU/EFTA investors, especially in the technology sector. Recently, two cases received strong attention, namely the acquisition of AIXTRON SE by a Chinese investor, as well as the strategic investment of the Chinese lighting company MLS and the financial investor Yiwu in the Osram's light bulb business.

Reportedly, various German government departments have commissioned consultations on a policy paper that might finally lead to a substantial expansion of the Ministry's review and veto rights.

HOW FOREIGN INVESTORS CAN PROTECT THEMSELVES

Parties to M&A transactions—whether public or private—should carefully consider the risk of foreign investment control procedures as typically being part of the due diligence process. If AWG/AWV rules apply, it may be appropriate that the acquirer initiates discussions with the Ministry even before the signing of an SPA, or, in case of a public deal, the announcement of the transaction. Depending on the timing and the type of offer, the purchase agreement or the public takeover offer and a related business

OUTCOMES

- For many years, there were no prohibitions of foreign investments in Germany reported.
- More recently, there is a growing trend by the German regulator to more closely scrutinize transactions, especially in the tech industries.
- While the changing mood has become obvious on a number of recent transactions and is reflected in a strategy paper published recently by the Ministry, the threshold in the current legislative environment remains high, requiring an actual and sufficiently serious danger for public order or security. Mitigation measures may include, for instance, ring-fencing of important IP and know-how, the condition to divest certain of the target company's activities or to keep certain production units in Germany.



combination agreement will contain corresponding condition precedents and covenants.

In sensitive sector transactions, foreign investments meeting the above-mentioned thresholds must be communicated to the Ministry and should not be closed before the acquisition is approved or deemed to be approved by the Ministry.

REVIEW PROCESS TIMELINE

For transactions, other than sector-specific transactions, the Ministry may initiate an ex officio review within three months after the signing, or the announcement, in case of a public takeover. If the Ministry opens a review on grounds of public order or security,

the acquirer will typically have to meet extensive documentation requirements with the support of the target company, which may cause a significant delay for the approval process to start. Within two months following receipt of all necessary documentation, the Ministry may either (i) issue a non-objection certificate, (ii) prohibit the acquisition or (iii) issue “instructions” (taking the form of mitigation measures) in order to ensure public order or security, the two latter cases requiring approval by the German Federal Government. Prohibitions and instructions with respect to acquisitions in sensitive sectors can be issued without German Federal Government approval.

To accelerate the process and gain certainty on the outcome of any review, the acquirer will typically apply for a formal and binding non-objection certificate. Such certificate is deemed to have been issued if the Ministry fails to open an examination procedure within one month of receiving the application.

If the target company is active in one or more of the sensitive sectors, the acquirer must notify the Ministry in writing and file the necessary documentation. The Ministry then explicitly approves the transaction, opens a review or does not respond. If the Ministry does not open a formal review within one month after the investor’s notification, the approval is deemed to be granted.

Russian Federation

Russia targets 45 “strategic activities” that trigger a national security review

The Government Commission on Control Over Foreign Investments in the Russian Federation (the Government Commission), which was established by the Russian Government in 2010, is responsible for reviews. The Government Commission is headed by the Chairman of the Russian Government and composed of the heads of certain ministries and other government bodies.

Although the final decision on the application is made by the Government Commission, all the preparatory work (i.e., reviewing an application’s completeness, liaising with relevant government bodies) is done by the Federal Antimonopoly Service (FAS). FAS, among other things, performs a preliminary review of the application and prepares materials for a further assessment by the Government Commission.

WHO FILES

An acquirer must file if the proposed acquisition would result in the acquirer’s control over an entity

exercising activities of “strategic importance” to Russian national defense and security (a Strategic Entity). The acquirer is required to obtain consent of the Government Commission prior to the acquisition of control over a Strategic Entity; otherwise, the respective transaction is void.

To apply for the consent, the acquirer must submit an application to the FAS with attachments, which include, among other things, corporate charter documents of the acquirer and the target, information on their groups’ structures (including the whole chain of control over both the acquirer and the target), transaction documents and a business plan for the development of the target post-closing.

TYPES OF DEALS REVIEWED

The Government Commission reviews transactions that result in acquisition of control over Strategic Entities. Currently, there are 45 activities of “strategic importance” that, if engaged in by the target, cause the target to be considered a Strategic Entity.



In 2015, FAS received 44 applications from foreign investors, and in 2016 this number continues to increase.

The 45 activities encompass, among others, areas related to natural resources, defense, media and monopolies.

The activities include not only those directly related to the state defense and security (e.g., operations with nuclear materials, production of weapons and military machines), but also certain other indirectly related activities (e.g., TV and radio broadcasting over certain territory, extraction of water bioresources and publishing activities). The criteria for determining control are rather wide and are different for a target

that is involved in the exploration of “subsoil blocks of federal importance” (e.g., oil fields with certain size of reserves, uranium mines, and subsoil blocks subject to exploration within a defense and security zone). Foreign public investors (i.e., foreign investors controlled by foreign states or international organizations) are not permitted to obtain control over Strategic Entities.

In addition, foreign investors also must obtain the Government Commission’s consent for certain transactions involving acquisition of a Strategic Entity’s property.

Certain transactions in respect of Strategic Entities or their property are exempt from the necessity to obtain the Government Commission’s approval (e.g., transactions in which the acquirer is ultimately controlled by the Russian Federation, constituent entities of the Russian Federation or a Russian citizen who is a Russian tax resident and does not have dual citizenship, as well as certain “intra-group” transactions).

SCOPE OF THE REVIEW

Generally, a review assesses the transaction’s impact on state defense and security.

FAS initially requests opinions of the Ministry of Defense and the Federal Security Service as to whether the transaction poses any threat to the Russian defense and security. Additionally, if the target has a license for dealing with information constituting state secrecy, FAS requests information from the Interagency Committee for the State Secrecy Protection on the existence of an

OUTCOMES

- Most transactions submitted to the Government Commission for review are approved. Such approval contains the term within which the respective acquisition needs to be completed.
- The Government Commission can approve the transaction subject to certain obligations imposed on the foreign investor. The list of such obligations is exhaustive and established by law (although there is a legislative proposal to open the list). Those obligations may include the obligation to process bioresources or natural resources extracted by the Strategic Entity on Russian territory.
- The Government Commission can reject the application for approval of the acquisition.

international treaty allowing a foreign investor to access information constituting state secrecy.

Russian law does not provide for more details on the review’s scope or the criteria on which the transaction is assessed.

TRENDS IN THE REVIEW PROCESS

In 2015, FAS received 44 applications from foreign investors, and in 2016 this number continues to increase. Most foreign investors are from Cyprus, China, United Arab Emirates, Switzerland, the US, France, Italy and India.

HOW FOREIGN INVESTORS CAN PROTECT THEMSELVES

At the early stage of a transaction, a foreign investor should analyze whether the target company

qualifies as a Strategic Entity and whether the planned transaction triggers the necessity of the Government Commission’s consent. This will allow the investor to start filing preparations and then file its application as early as possible, thereby reducing the filing’s impact on the timing of the transaction.

REVIEW PROCESS TIMELINE

The statutory period for reviewing the application is three months from the date of its acceptance for review. The Government Commission can extend the review period for an additional three months.

Australia

Australia requires a wide variety of transactions involving foreign businesses to be reviewed and approved before completion

The decision to approve or deny a foreign investment application is ultimately made by the Treasurer of Australia, based on an assessment of whether or not the investment would be contrary to the national interest. When making its decision, the Treasurer is advised by the Foreign Investment Review Board (FIRB), which examines foreign investment proposals and advises on the national interest implications.

Australia's foreign investment policy framework comprises the Foreign Acquisitions and Takeovers Act 1975 (the Act), the Act's related regulations and Australia's Foreign Investment Policy (the Policy).

WHO FILES

A foreign person or entity making an acquisition that requires approval under the Act must apply to FIRB for approval before completion of the acquisition.

An application includes filing fees that vary according to deal value.

TYPES OF DEALS REVIEWED

Approval is required for any acquisition by a foreign person of:

A substantial interest in an Australian entity (at least 20 percent for an entity valued at more than AUD 252 million (US\$191 million)). Consistent with Australia's commitments under the Act, a higher threshold of AUD 1.094 billion (US\$829 million) applies to investors from Chile, China, Japan, Korea, New Zealand and the US. However, the lower AUD 252 million (US\$191 million) threshold applies to these investors if they are investing in "sensitive businesses," which include media, telecommunications, transport, defense and military-related industries, as well as the extraction of uranium or plutonium and the operation of nuclear facilities.

A 10 percent or greater interest in an agribusiness with a value of AUD 55 million (US\$41.6 million) or more.

Any residential or vacant Australian land or any land for redevelopment (no threshold for acquired interest or deal value applies).

A developed commercial property, which has two categories: "sensitive," with a AUD 55 million (US\$193 million) threshold, and "non-sensitive," with a AUD 252 million (US\$191 million) threshold (entities with significant real estate holdings also have thresholds reflecting their underlying land interests).

A media business (when acquiring more than a 5 percent interest or any percentage non-portfolio interest).



In addition, all foreign government investors (which can include domestic or offshore entities where foreign governments hold at least a 20 percent interest) must get approval before acquiring a direct interest (i.e., at least a 10 percent interest or the ability to influence, participate in or control) in an Australian asset or entity, starting a new business or acquiring an interest in Australian land regardless of the value of the investment.

SCOPE OF THE REVIEW

The Treasurer may prohibit an investment if he or she believes it would be contrary to the national interest. In making this decision, the Treasurer will broadly consider:

- The impact on national security
- The impact on competition
- The effects of other Australian government laws and policies (including tax and revenue laws)
- The consequences for the economy and the community
- The character of the investor

OUTCOMES

- Generally, the Treasurer approves the vast majority of applications.
- However, FIRB has been increasingly willing to use conditions and undertakings as a mechanism to increase the government's oversight of more complex or sensitive investments. Undertakings required from FIRB may include matters relating to governance, location of senior management, listing requirements, market competition and pricing of goods and services (e.g., that all off-take arrangements must be on arm's-length terms) and other industry-specific matters. FIRB has also recently issued a set of standard tax conditions that apply to those foreign investments that pose a risk to Australia's revenue and make clear the requirements and expectations for investors.
- The Treasurer also has wide divestiture powers and can issue criminal and civil penalties for serious breaches of the Act.

TRENDS IN THE REVIEW PROCESS

Historically, there have been few rejections by the Treasurer on the grounds of national interest. There have been some significant investment proposals that have been rejected, however, including the blocking of Shell's proposed acquisition of Woodside in 2001, due to concerns over foreign ownership of Woodside's significant natural gas interests in Australia, and the blocking of Singapore Exchange's attempted takeover of the Australian Stock Exchange in 2011, as the transaction would have reduced Australia's economic and regulatory sovereignty over the Australian Stock Exchange.

More recently, the Treasurer has blocked these high-profile investment proposals:

Archer Daniels Midland Company's November 2013 proposed takeover of GrainCorp

(a leading Australian agribusiness). This was reported as a largely political decision, with the Treasurer citing that the proposed AUD 3.4 billion (US\$2.6 billion) takeover was contrary to the national interest and had the potential to undermine Australia's public support for the government's foreign investment policy. The Treasurer also noted his competition concerns, as approximately 85 percent of eastern Australia's bulk grain exports are handled through GrainCorp's ports network.

A foreign investor's April 2016 purchase of S. Kidman & Co Limited. The sale was deemed as against Australia's national interest due to the size and significance of Kidman's property portfolio which, at the time, was 1 percent of Australia's land mass and more than 2 percent of its agricultural land.

New South Wales's August 2016 plan to sell electricity distributor Ausgrid to Chinese and Hong Kong bidders. It was found to be not in the national interest due to national security concerns.

In September 2016, the Treasurer granted conditional approval for the Lonsdale Consortium, comprising both Australian and foreign investors, to acquire a 50-year lease on the Port of Melbourne. Importantly, CIC Capital, a subsidiary of the Chinese sovereign wealth fund CIC, and OMERS, a Canadian pension fund, would each hold a 20 percent stake in the port. A key reason behind the approval was that a number of foreign investors were part of the consortium and no individual foreign investor had a controlling interest. Further, the Treasurer has indicated that the proportions of foreign ownership of the port cannot be altered without the Treasurer's approval under FIRB's conditions on the acquisition.

HOW FOREIGN INVESTORS CAN PROTECT THEMSELVES

Foreign persons should file an application in advance of any transaction or make the transaction conditional on foreign investment approval, and a transaction should not proceed until the Treasurer advises on the outcome of its review. For a more sensitive application (e.g., transactions involving the banking, media and telecommunications sectors), foreign investors should consider taking up the Government's invitation in the Policy to engage with FIRB before filing an application for a significant investment. These discussions may help foreign investors understand national interest concerns the Government may hold about a particular proposal and the conditions the Treasurer may be considering imposing on the proposal should it be approved. These discussions can also help with structuring a transaction in order to reduce the likelihood of rejection.

Such discussions should be held at an early stage in order to provide enough time to satisfy all FIRB queries. Where there is a competitive bid process for the acquisition, a foreign investor that does not actively engage with

FIRB early in the bidding process may be placed at a competitive disadvantage to other bidders who do. Foreign investors should be prepared to discuss in detail any conditions and undertakings that may be requested by FIRB, especially for acquisitions that are likely to attract greater political or media scrutiny.

REVIEW PROCESS TIMELINE

Under the Act, the Treasurer has 30 days to consider an application and make a decision. The time frame for making a decision will not start until the correct application fee has been paid in full. The Treasurer may also extend this period by up to 90 days by publishing an interim order. An interim order may be made to allow further time to consider the exercise of the Treasurer's powers. Investors can also voluntarily extend the period by providing written consent.



FIRB has been increasingly willing to use conditions and undertakings as a mechanism to increase the government's oversight of more complex or sensitive investments.

Reducing M&A risks related to national security reviews

As national security reviews grow in impact, investors need to be mindful of potential adverse consequences resulting from such reviews

International M&A deal advisors are acutely aware of the growing impact of national security reviews on cross-border M&A transactions, particularly in light of the vibrant investment flows between China, the United States and the EU. Some consider such reviews to be the “new merger control.”

National security reviews have the potential to drastically change the nature of an M&A transaction or to derail it completely. The impact of a national security review and its outcome can range widely and may include an actual or de facto prohibition of the transaction if it is deemed necessary by the relevant authority to protect vital national security interests (an example of a de facto prohibition was the attempted sale of Lumileds by Philips to a consortium of Chinese investors, which was called off because the parties were unable to secure clearance by the Committee on Foreign Investment in the United States (CFIUS)).

More commonly, however, reviewing bodies address national security concerns by imposing conditions or mitigation measures

on the target and/or the acquirer. These conditions and mitigation measures may include divestiture of the target’s sensitive assets or other measures (e.g., intellectual property transfers, ring-fencing of certain data/information relevant to the target’s customers, governance restrictions, audit requirements or limitations on future investments).

With these risks in mind, a savvy investor should consider taking specific steps in structuring and planning its transactions to incorporate protections regarding applicable national security reviews.

STRUCTURING CONSIDERATIONS

National security reviews add an additional layer of complexity to an M&A transaction and increase potential uncertainties and risks to be considered when structuring the transaction. Regarding timing, parties should consider the review period under the national security review process once the submission for such review has been formally accepted by the relevant authority (understanding that, in practice, securing such formal acceptance requires preparation and often

pre-coordination with the relevant authority, which can cause delays). The overall timeline for national security reviews may vary significantly based on the applicable phases of the given national security review process. If clearance cannot be obtained prior to the applicable deadline for the transaction, such as the end (or long-stop) date or, in the case of a public tender offer, prior to the expiration of the acceptance period or the date on which shareholder withdrawal rights become available, then the parties risk that the transaction may not be completed.



A savvy investor should consider taking specific steps in structuring and planning its transactions to incorporate protections regarding applicable national security reviews.

In addition, the significance of these timing considerations may vary depending on whether clearance by the relevant authority is mandatory or voluntary (the latter being the case for filings with CFIUS and the German Ministry for Economic Affairs and Energy, among other authorities). For a voluntary review, the parties must consider the risks of closing the transaction prior to the receipt of clearance.

REGULATORY MATERIAL ADVERSE CHANGE (MAC) CLAUSES AND RELATED CONDITIONS

While the absence of a prohibition by a governmental authority of the proposed transaction is a customary condition precedent (CP) for any transaction, an acquirer would typically also want to specify in the transaction agreement the circumstances relating to the regulatory review process under which it would not be required to consummate the proposed transaction.

From the acquirer's perspective, CPs and covenants relating to the regulatory review process serve to protect the acquirer from having to consummate the transaction under circumstances where the government has imposed regulatory conditions or required mitigation measures that would change the nature of, or the business rationale for, the proposed transaction. Depending on the market practice in the relevant jurisdiction, the contract provisions intended to protect the acquirer from these risks may take the form of regulatory material adverse change clauses (regulatory MACs) and/or covenants that specify the level of effort that the acquirer must expend in order to obtain the necessary regulatory approval. These types of provisions are designed to allocate the regulatory risk between the target company and the acquirer and often provide for quantifiable thresholds (e.g., based on the target's consolidated sales and/or revenues) relating to the government-imposed regulatory conditions or mitigation measures

that, if exceeded, would allow the acquirer to abandon the deal (either outright or after payment of a penalty in the form of a reverse break-up fee).

In the case of public tender offers conditioned on the absence of a regulatory MAC, in many jurisdictions, such CPs are allowed only if the regulatory MAC provision is sufficiently precise and can be assessed by an independent expert.

As for covenants related to the level of efforts the acquirer must expend in order to obtain the necessary regulatory approvals, the obligation imposed on the acquirer may range from "hell or high water" commitments, which require the buyer to take all requisite action to obtain regulatory approval, to provisions that expressly state that the acquirer will not be obligated to agree to any government-imposed conditions and mitigation measures, including divestiture of assets, properties or lines of business, so that the acquirer has the option of either complying with any governmental requirements or abandoning the transaction.

BALANCING THE ACQUIRER'S AND TARGET'S INTERESTS

CPs, such as regulatory MACs, and covenants relating to the parties' obligations to obtain regulatory clearances and, if applicable, implement the government-imposed regulatory conditions and other mitigation measures, are often accompanied by reverse break-up fee arrangements which, in some cases may be backed by financial security or escrow arrangements, depending on the financial wherewithal of the acquirer. These provisions are designed to allocate certain financial risk to the acquirer if the transaction is not consummated due to regulatory reasons. While most investors are accustomed to the concept of reverse break-up fee arrangements, the risk that such arrangements will be triggered increases as thresholds for national security reviews and intervention become lower worldwide.

Depending on the applicable national security review regime, industry and products or services involved in a transaction, parties will often need to address on a case-by-case basis the level and extent to which each party should bear the regulatory risk.

RING-FENCING AS A BROADER TREND

A recent trend in dealing with anticipated national security reviews is the use of "ring-fencing" provisions in the transaction agreement. These ring-fencing provisions limit the acquirer's ability to either control or gain access to certain specified aspects of the target's business, assets or operations. These provisions are a form of self-regulation by the transaction parties to preemptively address and alleviate the likely national security concerns of the relevant authority regarding the particular transaction, as seen in some recent European transactions.

Ring-fencing measures are often aimed at protecting the target's intellectual property and know-how by increasing or establishing management's oversight duties. They may also include mandatory physical restrictions and cyber security plans or auditing processes. Such measures are frequently intended to address concerns that sensitive know-how is at risk and the existing safeguards at the target (e.g., management oversight) are not considered adequate. In fact, ring-fencing measures may also be imposed contractually by customers voicing their concerns in the event of a major transaction affecting their supplier.

Ring-fencing arrangements may, therefore, serve a number of purposes and help reconcile the interests of numerous stakeholders (including, in some cases, political interests) if a transformational transaction is being considered. Ring-fencing can also be done as a mitigation measure in response to specific concerns raised by a regulatory authority regarding a transaction. ■

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