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Foreign investments control in France: what impact on M&A transactions?

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The exponential growth of foreign investments, particularly in China and the United States, in recent years as well as the economic crisis linked to the recent outbreak of Covid-19, which has weakened many sectors of activity considered strategic by the States, have led many European States, to strengthen their control mechanisms for foreign direct investments (FDI). In France, the FDI control system is codified in the Monetary and Financial Code. Here is a review of this system and its impact on M&A transactions in a few key questions.

What is the legal framework for controlling foreign direct investments?

The French foreign investments control regime is one of the oldest in Europe, dating back to a law of 28 December 1966, which provides that foreign direct investments (the "**FDI**") in certain sectors deemed sensitive is subject to prior authorization by the Minister of Economy and Finance (the "**Minister**").

This control mechanism was extended and strengthened recently by the *Loi PACTE* of 22 May 2019, two implementing decrees of 31 December 2019 and 1 April 2020 as well as by a recent order of 10 September 2021, which came into force on 1 January 2022.

At the European level, under the impact of the exponential development of foreign investments in recent years a European Regulation 2019/452 of 19 March 2019, applicable since 11 October 2020 established a framework for screening foreign direct investments in the Union (the "**Regulation**").

This Regulation does not, per se, organize FDI controls at the European level, but it establishes a mechanism of cooperation within the member states by setting up an alert procedure for investments in crisis or strategic sectors. It grants the European Commission the power to send opinions to member states concerning investments to be controlled. The member state will have to follow this opinion or give reasons for its refusal.

More recently, on the 29 September 2021, the Commission voted the regulation 2021/2126 entering into force on 23 December 2021 and amending the annex of the Regulation by completing the definition of investment of interest to the Union and likely to be subject to control. Thus, the list of projects and subsidy programs that make the investment target interesting has been expanded.

It is within this framework that more than ten member states have implemented or significantly modified their FDI control mechanisms.

Which are the foreign investors concerned?

Only the investors, natural or legal person, of foreign nationality are concerned by this procedure.

According to the texts, is considered as foreign investor:

- any individual of foreign nationality;
- any individual of French nationality who is not domiciled in France for tax purposes;
- any entity governed by foreign law;
- any entity governed by French law that is controlled by the above-mentioned persons or entities.

The qualification of foreign investor has been clarified by the latest reforms, thus facilitating the assessment of the applicability of the procedure to the envisaged operation. In particular, within the chains of control it will be necessary to identify a person responsible for the investment. In particular, when a subsidiary or intermediate holding company is a foreign investor, this qualification will be retained even if the ultimate beneficiary is again a French legal entity.

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Which investments are subject to the clearance?

The prior authorization regime applies only to the investments in strategic sectors from foreign investors which result in any one of the following transaction:

- the acquisition of control, within the meaning of Article L. 233-3 of the French Commercial Code, of an entity governed by French law;
- the acquisition of all or part of a branch of activity of an entity governed by French law;
- the crossing, directly or indirectly, alone or in concert, of the threshold of 25% of the voting rights of an entity governed by French law. This threshold has been reduced to 10% for companies listed on a regulated market (Euronext) until 31 December 2021. As an exception, investors who are national of a member state of the European Union or of a state party to the agreement on the European Economic Area that has concluded a bilateral agreement with France to prevent tax evasion and avoidance, are excluded from the scope of the system.

What are the strategic sectors of activity concerned by the clearance process?

The list of strategic activities falling within the scope of the scheme is set out in Article R. 151-3 of the Monetary and Financial Code.

However, some of these sectors are broad. Thus, companies that doubt the qualification of their activity as sensitive can ask the Minister for an opinion, which must be answered within 2 months.

In contrast to the request for authorization, which can only be submitted by the investor, the request for an opinion can also be submitted by the target company. This means that the target will be able to ask the question in advance and once and for all for the activity that it carries out.

The strategic activities covered are 11. These are those:

- relating to weapons, ammunition and explosive substances;
- relating to dual-use goods and technologies;
- carried out by entities holding national defense secrets;
- relating to information technology systems and their security;
- carried out by entities having concluded a contract for the benefit of the Ministry of the Armed Forces for the realization of a good or service falling under a sensitive activity;
- relating to cryptology;
- relating to gambling, with the exception of casinos;
- intended to deal with the illicit use of pathogenic or toxic agents or to prevent the health consequences of such use;
- relating to the processing, transmission or storage of data, the compromise or disclosure of which is likely to affect the exercise of sensitive activities;
- relating to R&D concerning to critical technologies (cybersecurity, artificial intelligence, robotics, additive manufacturing, semiconductors, quantum technologies, energy storage, biotechnologies and technologies involved in the production of renewable energy) or to dual-use goods and technologies, when they are intended to be implemented in the context of the sensitive activities mentioned above;
- on essential infrastructure, goods or services to ensure:
  - the supply of energy and water;
  - operation of transport networks and services;
  - operation of electronic communications networks and services;
  - space operations, as defined by law no. 2008-518 of 3 June 2008 on space operations;

1. *"I.- Any person, whether natural or legal, is considered, for the application of sections 2 and 4 of this chapter, as controlling another:*

1° when it directly or indirectly holds a fraction of the capital giving it a majority of the voting rights in the general meetings of that company;

2° where it alone holds a majority of the voting rights in that company by virtue of an agreement concluded with other partners or shareholders which is not contrary to the interests of the company ;

3° where it determines in fact, by the voting rights it holds, the decisions in the general meetings of that company;

4° if it is a partner or shareholder of the company and has the power to appoint or dismiss the majority of the members of the administrative, management or supervisory bodies of the company.

II.- It is presumed to exercise this control when it has, directly or indirectly, a fraction of the voting rights greater than 40% and no other partner or shareholder has, directly or indirectly, a fraction greater than its own.

III.- For the application of the same sections of this chapter, two or more persons acting in concert are considered as jointly controlling another person where they in fact determine the decisions taken at a general meeting."

- the exercise of the missions of the national police, the gendarmerie, the civil security services, as well as the exercise of the missions of public security, customs and those of approved private security companies;
- space operations, as defined by law no. 2008-518 of 3 June 2008 on space operations;
- the exercise of the missions of the national police, the gendarmerie, the civil security services, as well as the exercise of the missions of public security, customs and those of approved private security companies;
- the operation of establishments, installations and works of vital importance, as defined in articles L. 1332-1 and L. 1332-2 of the Defense Code;
- the protection of public health;
- national food security;
- publishing, printing or distribution of political and general information press publications.

What is the FDI clearance process ?

The new regulations have led to a simplification of the authorization procedure, which is now divided into two phases.

First phase: An Order dated 10 September 2021 clarifies the information and documents contained in the application file, adapting them to the requirements imposed by the Regulation.

The application for authorization can only be filed by the investor or the person responsible within the same chain of control.

Once the application is filed, the Minister, in practice an office of the Treasury Department of the Minister (Bureau Multicom 4), has 30 business days to decide on the application. From then on, three options are available to him:

- the operation does not fall under the authorization procedure;
- the operation is authorized unconditionally; or
- the operation is subject to further examination.

If no response is received within this period, clearance is deemed to be refused.

When reviewing, the Treasury Department will be able to interact with the ministries concerned to identify the appropriateness of qualifying the activity as sensitive. This assessment will be made on the basis of a number of indicators, such as the economic context in which the target is located, or the time required to find an alternative solution to that proposed by the target.

Second phase: in case of further examination of the application, the Minister has another 45 business days starting from the date of Minister's first decision, to authorize or refuse the investment. If no response is received within this additional period, clearance is deemed to be refused.

When the authorized investment is carried out, it gives rise to a declaration within 2 months following the definitive realization of the investment with the Multicom 4 office.

Are there any exemptions?

Exemptions are provided for when the investment is made within the same group or when the investor crosses the threshold of 25% of the voting rights of an entity over which it had already acquired control upon authorization of the Minister.

Also, where the investor acquiring control has already obtained the Minister's approval for crossing the 25% voting rights threshold, it will be exempted from a new approval procedure but will have to give prior notification of the transaction. The Minister will have 30 days to object.

A new exemption has been introduced by Decree n° 2020-892 of 22 July 2020 for companies whose shares are listed on a regulated market. When the planned investment falls within the scope of the procedure because the threshold is lowered to 10%, the investor must notify the Minister of the transaction. The Minister will then have a period of 10 days to oppose the transaction. If the investor fails to do so, the transaction will be deemed to be authorized and must take place within 6 months of the notification.

What conditions can be attached to the authorization of a foreign investment?

The *Loi PACTE* of 22 May 2019, strengthened the Minister's in case of non-compliance with the control system.

Any foreign investment concerning a sensitive activity made without authorization is void. This sanction is provided for in Article L. 151-4 of the Monetary and Financial Code and may be covered by the Minister's authorization of the investment a posteriori.

The Minister may also take precautionary measures against the investor in case of non-compliance with the control procedure, such as:

- suspension of the voting rights attached to the portion of the securities whose holding by the investor should have been subject to prior authorization;

- the prohibition or limitation of the distribution of dividends or remuneration attached to the securities whose holding by the investor should have been subject to prior authorization;
- the prohibition or limitation of the distribution of dividends or remuneration attached to the securities whose holding by the investor should have been subject to prior authorization
- the suspension, restriction or temporary prohibition of the free disposal of all or part of the assets related to the activities carried out in sensitive areas;
- the appointment of an agent responsible for ensuring the protection of national interests within the company to which the activity belongs.

Finally, the Minister has the power to issue injunctions when the commitments conditioning the authorization have not been respected.

What is the impact of FDI control on M&A transactions ?

Although the World Investment Report, published in 2021 by the United Nations Conference on Trade and Development, states that the number of operations controlled in France has doubled between 2017 and 2020, cases of investment refusal remain rare.

According to a report by the European Commission on the screening of FDI into the Union, published on 23 November 2021, these investments concern mainly the manufacturing sector, ICT, wholesale, and retail. About 400 foreign investments have been screened, where 80% of the transactions did not justify further investigation and were thus assessed by the Commission in just 15 days. Also, the Commission issued an opinion in less than 3% of the first 265 cases screened. This shows that the European FDI cooperation mechanism would not create unnecessary delays for transactions.

It is certain that the Minister's decision can be appealed in full (recours en plein contentieux) before the administrative judge. However, the administration favors a negotiation approach rather than a total refusal, thus reducing the risk of litigation.

Indeed, the authorization of the investment can be pure and simple or subject to commitments, such as the maintenance of the activity in France, the compartmentalization of sensitive information within the group, the establishment of the head office in France or the setting up of a security committee with a right of veto on sensitive decisions within the competence of the board of directors, composed of the company's officers and a government representative. For the moment, the government excludes the US system of proxy boards.

Although the government is reluctant to interfere fully in the governance of the target, it may condition its approval on the transfer of a portion of the shares to an entity separate from the investor. This was the case in the Photonis case.

Obviously, an investor who does not wish to comply with these undertakings may withdraw its offer to purchase.

How should foreign investors take into account the control framework in their M&A process ?

The broadening of the scope of application of the system means that a greater number of acquisitions are likely to be subject to control.

The list of activities considered as sensitive has been extended to new activities such as food safety, print media, digital information and certain critical technologies.

The information obligations of investors have been reinforced. Investors are now obliged to inform the administration of the links they maintain with foreign States, in particular by declaring the public subsidies they receive, the public contracts they obtain, and the stakes held in their capital by these States. Also, when the investor, or the person responsible within the chain of control, is an investment fund, the identity of the fund manager and the persons controlling the said manager must be communicated.

The status of foreign investor, the nature of the proposed transaction and the sensitive nature of the activity carried out by the target are cumulative conditions for the application of the FDI control regime.

Any foreign investor seeking to acquire a stake in a French company whose activity falls within the scope of the control mechanism will then have to consider whether it qualifies as a foreign investor pursuant to the mechanism and, if so, whether the target company's activity is critical. This order of reasoning is important because if the investor is not foreign, the verification of the sensitivity of the activity, which is currently less regulated and therefore more uncertain, will not be relevant.

This expansion could have an impact on M&A transactions, particularly in the exit strategies of Private Equity funds, which could face fewer potential foreign buyers.

In practice, if the proposed acquisition falls within the scope of the control, the procedure and its deadlines should also be taken into account when negotiating the letter of intent (Term sheet). The Minister's prior authorization generally occurs between signing and closing as a condition precedent to the closing of the transaction, as is the case in merger control. When clearance has been granted, a post-closing notification shall have to be filed with the Treasury Department within two months following the closing of the transaction.

In doing so, the foreign investor (or the target in case of a request for advice) will be advised to contact the Treasury Department as soon as possible in order not to delay the acquisition process and will have to be prepared to comply with any commitments imposed by the Minister.

Contacts

Stéphane Bénézant
Partner, Attorney-at-law
Corporate/Mergers & Acquisitions

T +33 (0)1 41 16 27 30
M +33 (0) 6 80 94 71 04
E sbenezant@avocats-gt.com

Marc Huynh
Attorney-at-law, *Senior*
Corporate/Mergers & Acquisitions

T +33 (0)1 41 16 27 36
M +33 (0)6 80 42 97 45
E mhuynh@avocats-gt.com

Grant Thornton Société d'Avocats
29, rue du Pont
92200 – Neuilly-sur-Seine, France
www.avocats-gt.com

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