

39th IBA International Financial Law Conference May 2024

Proliferation of FDI rules all around the world

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Agenda

- Proliferation of Foreign Direct Investment / “National Security” Regimes
- What are FDI Regimes aimed at?
- What Does All This Mean for Deal-Makers?
 - Managing the Timeline
 - Regulatory Strategies
 - Evolving Deal Terms

Global Expansion of FDI / “National Security” Regimes

- Europe:
 - EU-wide cooperation framework
 - U.K. National Security and Investment Act 2021
 - New and proposed (or beefed up) FDI regimes in many EU member states
- USA
 - CFIUS jurisdiction expanded under FIRRMA in 2018
 - Mandatory filing regime implemented and increased emphasis on enforcement
- Asia-Pacific:
 - India
 - China

What are FDI Regimes aimed at?

- Industries with “national security” implications
 - “National security” defined broadly or not defined at all
- Access to personal data / payments data; critical / emerging technologies; critical infrastructure
- Presence of involvement of government ownership or influence
 - Transaction structures (look through entities to see where money comes from)
- Ties to “countries of concern” (i.e., not just focused on the foreign investor / acquiror’s home country)
- “Economic security” considerations (e.g., domestic manufacturing capabilities, supply chain resilience, etc.)

Challenges for deals and advisors

- Increasingly hard to predict what will be objectionable and why
 - Especially true for “national security” regimes
 - What does it mean?
 - What are national priorities?
- Increasing cooperation between reviewing agencies of allied or partner nations
 - For example, cooperation mechanism ensures that all EU member states will know of any deal formally notified in the EU
- Increasingly hard to predict:
 - Can we get the deal through?
 - How long will it take?
 - What deal terms and structures should we include in combination agreements?
 - What conditions / mitigation measures will the regulator require?

Managing the Timeline:

- Have to anticipate substantially longer timelines to closing
- Some of the time pressure comes from merger control regimes:
 - Policy changes (e.g., big is bad) lead to higher scrutiny of deals
 - More in-depth reviews and second requests
 - Novel theories of harm
- Some from FDI regimes:
 - Multi-jurisdictional reviews may extend timelines or kill deals
 - It only takes one regulator to kill a deal
- Is litigation even possible in FDI challenges? Are companies willing to litigate?

How to prepare:

- What are the required approvals?
 - Where are the substantive issues?
 - Which jurisdictions are likely more amenable to remedies?
 - What about voluntary jurisdictions?
- What regulators may have an interest?
 - In EU, member states may request the EC to investigate even if deal does not meet thresholds (Article 22)
- Prepare for coordination/cooperation among regulators
- Regulators will likely request waiver to permit sharing of information
- Strategy, coordination and consistency are key
- Communications strategy can be just as important as legal strategy

Other Constituencies / Considerations

- Commitments to customers, suppliers, labor
 - Do you reach out to constituencies that could have concerns about a deal?
 - Do you negotiate arrangements to ameliorate their concerns?
- Competitors
 - Frequently act as “spoilers”
 - Regulators often listen to competitors especially for new theories
- Other regulators / state actors
 - There may be competing state interests
 - FDI clearance may be used to advance other political objectives
 - When does FDI screening become a protectionist / economic policy tool?
 - EU Foreign Subsidies Regulation (beginning in September 2023)
 - What are the early indications of impact on deals?
- Fix-it first strategy?
 - When might you negotiate an upfront divestiture if it is likely required?
 - What protections (e.g., subject to main deal closing)?

How are deal terms evolving In response to the tough regulatory environment?

- Outside Dates – getting longer and longer
 - 18 months is increasingly common (even in PE deals) where regulatory issues are anticipated
 - Ability to push out to 24 months becoming more common
 - Need to accommodate option to litigate for FDI?
- Combination agreements increasingly including mechanisms to compensate target shareholders for time delays
 - “Ticking fee” kicks in after specified period
 - Sometimes kicks up after period
 - Target ability to pay or increase dividends to its shareholders
 - Buyer pays seller’s regulatory clearance costs
 - Interim cash pay-outs by buyer to target *shareholders* as timeline extends
 - Regulatory reverse termination fee increasing with time
- Regulatory covenants evolving
 - “Hell-or-high-water” increasingly rare
 - Even “reasonable best efforts” without express limitations
 - Regulatory reverse termination fees common (even with HOHW)

Impact of increased regulatory risk on Interim Operating Covenants

- Two problems push sellers to seek looser IOCs
 - Delay means IOCs will operate for longer
 - Greater closing risk increases risk of seller if IOCs too tight/business conditions change of
 - Buyer breaching the agreement (or seller alleging breach to get out)
 - Damage to Seller's business if the deal does eventually collapse
- Possible solutions:
 - General weakening of IOCs
 - Covenants weaken or exceptions increase over time
- Specific “hot button” IOCs:
 - Interim financing at the target
 - Changes to “Material Contracts”
 - Compensation changes (including incentive compensation) for senior management
- Interplay between “gun jumping” concerns and IOC consents
- Regulatory risk and delay adds challenges to buyer financing
 - Longer term debt very expensive if available at all
 - Can be especially problematic in PE deals

Looking to the future ...

- Decades of increasing globalization have given way to a few years of retrogression.
- Which way is the pendulum swinging and how fast?
- How will 2024 elections in a number of countries affect FDI screening?