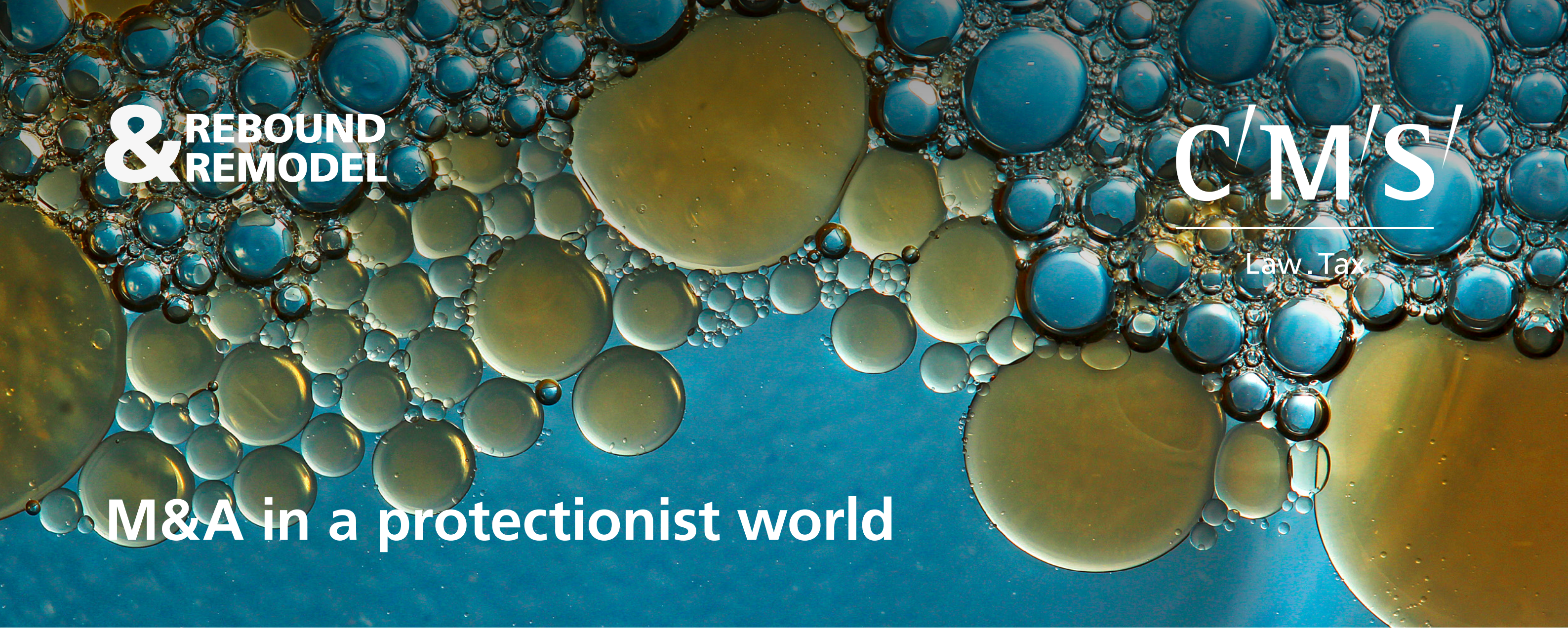


M&A in a protectionist world

Recent years have seen an increasing retreat from globalisation. While the COVID-19 pandemic has seen some business practices accelerate (such as cloud-based working), it has also seen an acceleration of protectionist measures as governments seek to protect their hard-hit economies and companies from overseas suitors. While historically interference in M&A has generally been restricted to selected sectors, such as defence, foreign investment controls are becoming increasingly prevalent across a broad range of economic activity.

M&A activity has long required those involved to consider whether the transaction gives rise to any competition or anti-trust concerns which may require the need for approval from relevant authorities. In addition, cross-border transactions can involve issues of foreign direct investment (FDI) limitations in certain jurisdictions. In the period following the millennium, barriers to cross-border transactions were generally reducing as globalisation powered ahead, and cross-border trade, including M&A and joint venture transactions, became easier.

The "Global Financial Crisis" effect

Through the mid-2000's, global trade expanded faster than anyone could imagine, as countries around the world, from the developed economies to the so-called "frontier markets", took advantage of improved connectivity, both physical and virtual. Global real-time communications became available to all and global air and sea-borne transport boomed. Economies opened up as governments and investors seized the new opportunities which presented themselves.

Then, in 2008, the "Global Financial Crisis" set in. As the financial sector suffered, governments around the world were forced to bail out their banks. Unlike the COVID-19 pandemic, the physical effects of the crisis were largely contained within the financial sector, as employees were made redundant and the supply of finance dried up. For the rest of the economy, the consequences were felt mostly around the availability of credit and other forms of finance, although governments were left with huge debt piles to service.

Key issues

- The COVID-19 pandemic has accelerated the trend in many countries around the world adopting increasingly protectionist policies with new rules being introduced and existing rules being more widely applied.
- Investors and buyers need to consider the risk of a foreign investment filing or approval being required, taking account of the applicable laws and how relevant authorities approach their application.
- M&A professionals will need to factor in checking on the latest foreign investment requirements in all jurisdictions in which a target business operates for the foreseeable future, in addition to merger controls and other regulatory approvals.

Austerity became the buzzword when it came to budgeting. As governments sought to boost their economies, particularly through the mid-2010's, there was an increasing focus on retaining business within an economy and not outsourcing it to other, cheaper jurisdictions. This change in focus is illustrated by Donald Trump's "Make America Great Again" slogan and Narendra Modi's "Make in India" campaign, and the increasing tensions between China and other countries.

The COVID-19 effect

As countries were becoming increasingly protectionist through the tail end of the 2010's, COVID-19 emerged, and suddenly global supply chains were closed down, as both businesses and transport links suffered varying degrees of lock-downs and delays. Businesses had to rapidly rethink their supply chains having been exposed to what had previously been considered a (very) minor risk.

Virtually all parts of the economy have been impacted by COVID-19 in one way or another, some positively (such as technology and communications) and others very negatively (such as hospitality and retail). Governments around the world have extended unprecedented support to economies, severely weakening their financial strength just as the businesses on which they rely have been similarly weakened. This combination of effects has increased the concerns of governments around the world that opportunistic and exploitative acquirers will be able to come in and buy up their domestic businesses and move them off-shore, further weakening the scope for future recovery as jobs and technologies are lost.

Increasing protectionism

The COVID-19 pandemic has led to many countries around the world adopting increasingly protectionist policies. Even before the pandemic hit, such policies were being increasingly adopted around the world. In the US, the Trump administration was increasingly using national security claims as a basis for challenging international trade, perhaps most notably in the automobile sector.

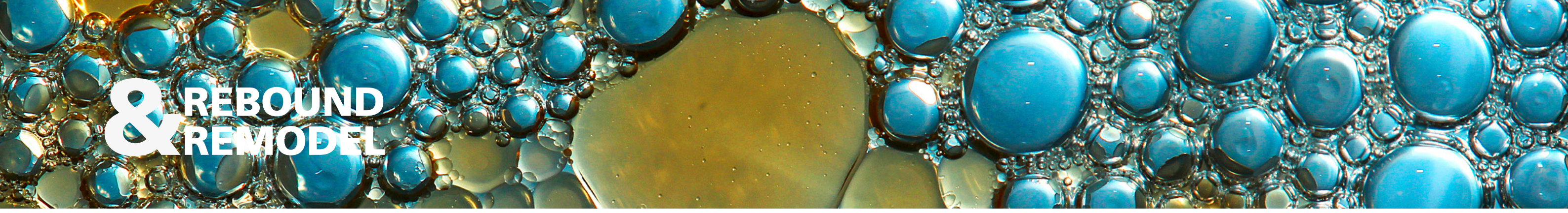
In Europe, countries have increasingly turned to national interest positions, expanding from the historical norms of protection applying in the defence and media sectors to become considerably more expansive. In the UK for example, in the space of a few days the government introduced protections to apply in businesses which are seen as critical to a pandemic response, accelerating a process which would normally have taken a couple of months. As well as applying to businesses in the healthcare sector, the UK government has also said that in its view, this new regime could also apply to both businesses capable of re-tooling to assist a pandemic response (such as manufacturers retooling to make PPE or ventilators) and internet service providers (which are seen as being important for communicating pandemic response initiatives to the public).

As well as its initial move to protect businesses which are important for responding to a pandemic, the UK government also moved to protect businesses which are involved in advanced manufacturing, artificial intelligence and cryptographic authentication technology by bringing them within the UK's public interest review regime. An even broader regime is planned to be introduced in the coming years, which will extend the reach of the national interest review regime, particularly in the technology sector.

Hungary already had a broad foreign investment control regime, covering both direct or indirect acquisitions as well as acquisitions of dominant influence, establishment of a new business entity and some asset deals as well. In addition, as a result of the COVID-19 pandemic, additional interim legislation has been introduced applying to 'strategic companies'. The new legislation catches all sorts of business activities and sectors from telecommunication, media and transportation to healthcare and many others and applies to share acquisitions and business transfers as well.

Until recently, Romania had retained a relatively light regime, with only targeted additional restrictions being introduced on the back of COVID-19 such as the introduction of a temporary prohibition on the transfer of controlling stakes in companies which are part of the National Energy System. However, new legislation is currently under debate with a view to amending the framework for screening foreign direct investments in Romania. The new legislation is aimed at implementing the EU Regulation on foreign direct investment and a much stricter process is foreseen. Even though the new legislation may bring more clarity and predictability, it will also bring additional obligations, conditions and sanctions.

The position is similar in most countries across Europe, with transactions with even small local operations in countries such as Italy being delayed while the necessary approvals are sought. In Germany, investments in specific sectors, such as critical infrastructure, media or certain healthcare companies, require mandatory notifications and the triggering threshold has been lowered to 10% of the voting rights. Importantly, German law covers both direct and indirect foreign investments, capturing acquisitions of foreign companies with German subsidiaries. With no less than 10 amendments in the past three years, German investment control remains a moving target. Most importantly, the introduction of a standstill obligation for many transactions will dramatically change the scene, as infringements will be punishable by prison sentences.



Beyond COVID-19

What is clear for those engaging in cross-border M&A is that countries around the world are becoming increasingly protective of their economies and industries, with new rules being introduced and existing rules being more widely applied. It is no longer the case that jurisdictions where there is a small subsidiary operation can be ignored or where the acquirer is from what used to be regarded as a "safe" jurisdiction (such as the US or Canada) – almost any transaction has the ability to fall within the ambit of a local review where there are assets or business in that jurisdiction. Unfortunately, international M&A transactions being caught up in multi-jurisdictional filings and investigations are no longer just the domain of the largest deals or merger control rules.

As a result, investors and buyers will need to look closely at a target's operations and take advice in each jurisdiction to understand the risk of a filing or approval being required, both under the black-letter law and under the enforcement approach of the relevant authorities. This is likely to lead to additional upfront costs for buyers, but a buyer would be unwise to spend the even greater sums involved in executing a transaction only to find out there are problems later.

Given how this area has developed over the past five years, absent a change in political attitudes to international trade and globalisation, we are unlikely to see any fast rolling-back of measures which have been recently introduced and more likely to see tightening of regimes continuing. The challenge for governments will be balancing attracting investment into their countries against protecting their domestic industries. For investors and buyers, key will be seeing very clear rules for establishing whether a transaction is subject to the regime and, if it is, having an efficient, fast and inexpensive process for conducting any review.

While we all hope to see COVID-19 retrenching in the near term, M&A professionals are unlikely to see much retrenching on national protectionism anytime soon and will need to factor in tighter controls for the foreseeable future.

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