International Trade Alert

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2022 Foreign Investment Review and What to Expect in 2023

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Key Points

Reviewing inbound foreign investment for national security risk continues to be a high priority for governments worldwide. Key developments and trends include the following:

- Countries continue to strengthen existing mechanisms, and at least four new mechanisms are expected to come into force in 2023.
- Countries are increasingly leveraging their authority to review and in some cases mitigate more transactions. Along those lines, businesses should expect to see greater enforcement and more transactions "called in" by authorities.
- In most cases, parties can negotiate mitigation conditions to address identified risks. At least 20 transactions were blocked or abandoned due to national security concerns[1] in 2022 and most reported blocks involved Chinese investors.
- Transactions involving sensitive technology, including semiconductor development and production, and energy, continue to be seen as posing higher risk, with a growing focus on personal data and mining.
- Authorities are increasingly sharing information across borders, which could lead to further convergence in identifying and mitigating risks.

In addition, it is likely that the United States (U.S.) will take action to address perceived risks from outbound investment to countries of concern such as China, and the issue is expected to be debated in Europe.

United States

The U.S. Government remains focused on risks from foreign investment and leveraging the full authority of the Committee on Foreign Investment in the United States (CFIUS).

CFIUS closely scrutinizes key risks. In September 2022, President Biden issued Executive Order 14083 (EO), "Ensuring Robust Consideration of Evolving National Security Risks by [CFIUS]," which is the first presidential direction on national security

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risks since CFIUS was established over three decades ago. While the EO largely memorializes CFIUS's current practice, it does signal the importance this Administration places on investment screening and highlights a few points that are particularly noteworthy, including an emphasis on whether the transaction (i) involves a sector identified as "fundamental" to U.S. technological leadership, including microelectronics, artificial intelligence, biotechnology and biomanufacturing, quantum computing, advanced clean energy and climate adaptation technologies and (ii) whether the transaction will afford the foreign investor access to large sets of sensitive data. [*See Client Alert "Executive Order Outlines Expansive National Security Considerations for CFIUS"*] As an example, CFIUS scrutiny of TikTok has been ongoing and primarily focused on the personal data that this social media application collects regarding U.S. citizens.

Investors must understand third-party relationships. The EO also highlights that CFIUS considers not only the foreign persons who are acquiring interest in U.S. businesses, but also foreign investor's third-party ties, including commercial ties, to foreign adversaries or countries of special concern, which is understood to include China as well as Russia.

CFIUS is reviewing an increasing number of cases, but mitigation remains more common than blocking. The 2022 CFIUS Annual Report, covering 2021, shows an increase in reviews from 249 in 2018 to 436 in 2022. CFIUS continues to mitigate roughly 20 to 30 transactions per year. [*See client alert "CFIUS Reports Significant Uptick in Filings and Non-Notified Inquiries"*] While there have only been six presidential blocks in 30 years, around 10 transactions are withdrawn and abandoned by parties annually due to CFIUS being unable to identify mitigation conditions or the parties being unwilling to accept proposed conditions. For example, a Chinese investor recently announced that its investment in a U.S. company with expertise in a novel flow chemistry would be abandoned due to CFIUS concerns.

Businesses should expect increased enforcement. In October 2022, the U.S. Department of the Treasury, which chairs CFIUS, published its first enforcement guidelines regarding mandatory filing requirements, including those related to U.S. businesses critical technologies, and compliance with mitigation agreements, and Assistant Secretary for Investment Security Paul Rosen stated that CFIUS "will not hesitate to use all of its tools and take enforcement action." Penalties can be imposed up to the value of the transaction. CFIUS also continues to expand its resourcing to call in transactions that parties have not filed, especially those involving Chinese or Russian investors. For example, in 2022, CFIUS reviewed a 2021 Chinese acquisition of majority ownership in a U.S. energy storage company (with a market segment focused multi-family dwelling units including military housing), and reportedly identified risks related to critical technology transfer; the company is now divesting its interest.

CFIUS is increasing engagement with allies and partners. CFIUS continues to advise allied countries in establishing and implementing their own investment review mechanisms and is increasing its tactical engagements. While CFIUS rarely shares information that has been filed by parties due to confidentiality limitations, it can share a range of information about threats and vulnerabilities and alert partners to transactions that CFIUS has discovered other than through case filings.

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Expect decisions on Excepted Foreign States (EFS) and potentially expansion of real estate jurisdiction. Prior to February 13, 2023, CFIUS will have to determine whether the United Kingdom (U.K.) and New Zealand have sufficiently robust investment review mechanisms to remain EFS (joining Australia and Canada for which such determinations were made in 2022). Investors from EFS that meet specified criteria are excepted from part of CFIUS's jurisdiction and from mandatory filing requirements. Following a determination by CFIUS that it did not have jurisdiction over a purchase of real estate near a government base by Chinese investor Fufeng, CFIUS and/or Congress also could take action to expand CFIUS's jurisdictional reach over real estate transactions to capture additional transactions going forward.

United Kingdom

The UK Investment Security Authority (ISU) was established pursuant to the UK National Security & Investment Act (NSIA), which entered into force January 2022. The ISU has not shied away from using its call-in powers although most deals reviewed have been proactively notified to the ISU. There have been 14 mitigation cases to date, including five effective blocks/reversals.[2] Judicial reviews are starting to be brought, with final judgment not expected typically for 9-12 months. High-level statistics on notifications and called-in transactions are likely to be published in the next annual report of the ISU at the end of March 2023.

Investors must file notifications in a range of sectors. Mandatory notification is required for investments of greater than 25 percent in qualifying entities active in one or more of 17 sensitive sectors, including among others, Advanced Materials, Quantum Technology, Advanced Robotics, Artificial Intelligence, Military and Dual-Use, Data Infrastructure and Energy.[3] So far, notifications have largely involved targets in the Defense, Dual Use technology, Energy and Advanced Materials sectors.

Most transactions are reviewed quickly. The majority of cases reviewed by the ISU have been reviewed within the first 30 working days. Voluntary notifications have been limited largely to asset deals, the acquisition of a material influence over policy, and borderline cases (where it is not clear whether target's U.K. activities fall within one or more of the mandatory sectors).

Call-ins have been relatively uncommon. The Secretary of State for Business Energy and Industrial Strategy (SoS) can call in a transaction for review, and potentially block or mitigate it, if he reasonably suspects the acquisition or other covered arrangement has given, or may give, rise to a risk to national security. There are three main risk factors that will be considered by the SoS in the exercise of the call-in powers[4]—target risk, acquirer risk and control risk—which are similar factors to those used by other authorities such as CFIUS.

The U.K. is exercising its blocking authority. The SoS has effectively reversed or blocked five transactions so far, with targets active in the development of products with military/dual-use, owning and operating a semiconductor fabrication plant, and a fiber optic broadband network. In fact, two of the five prohibitions relate to targets involved in producing semiconductors. For example, the ISU prohibited the acquisition of Pulsic Limited by Super Orange HK Holding Limited, a Chinese chip-design software developer based on concerns that Pulsic's "dual-use" technologies could be exploited

without user knowledge "*to build defence or technological capabilities*." Four of the five prohibitions involved Chinese acquirers.[5]

Businesses should expect more active enforcement this year. We expect the U.K. to actively utilize its authority to protect its national security, which is interpreted expansively to include a wide array of U.K. security and industrial policy interests.

The U.K. shares information with allies. The ISU and SoS confer with key U.K. government departments and authorities, including the Ministry of Defence, FCDO, DCMS and the Competition & Markets Authority, as well as their allied counterparts, in particular the other "Five Eyes" countries (the U.S., Canada, Australia and New Zealand). Although the U.K. is not part of the cooperation and information-sharing under the European Union (EU) Regulation on Foreign Investment Screening discussed below, in appropriate cases and with the requisite consents, the ISU may reach out to certain EU-based bodies.

European Union

The number of EU Member States with a foreign investment review authority increased from less than half in 2018 to two-thirds by 2022, and currently all but two Member States (Bulgaria and Cyprus) have or are in the process of establishing mechanisms. The authorities differ, however, in terms of the scope of jurisdiction, voluntary versus mandatory requirements, and timelines for review. The EU Commission has called for all Member States to have investment review authority.

More investment review mechanisms are coming into effect. Review mechanisms are expected to come into effect this year in **Belgium, Ireland** (with retroactive effect to any transactions completed in the 15 months prior) and **Estonia**. The **Netherlands**, which currently has targeted authority, also is expected to launch a new, broader review system, which among other things will give it greater authority over transactions involving sensitive technology and energy (with retroactive effect to call in transactions that have taken effect after September 8, 2020). The entry into force of the **Swedish** regime is expected in 2024. In recent years, **Czech Republic**, **Denmark** and **Slovakia** established new regimes.

Countries with existing mechanisms continue to expand their authorities. For example, **France**, where the investment screening process was introduced over 50 years ago, has since 2019 been strengthening its enforcement powers and introducing new strategic sectors, extended through 2023, that, among other things, lowered the threshold to 10 percent for reviewing foreign investment in certain companies with research and development in sensitive technologies, including for the production of renewable energy. France also issued new investment review guidelines in September 2022. **Germany**, which had traditionally adopted a less interventionist approach toward foreign investment, starting from 2017 began tightening its screening in strategic sectors. In 2022, Germany amended its Ordinance Designation of Critical Infrastructure and, among other things, lowered the threshold for screening foreign investments in certain strategic sectors (such as energy) to 10 percent. In **Italy**, where the foreign investment regime was introduced in 2012, new permanent amendments came into force on January 1, 2023, replacing temporary amendments which followed the spread of the COVID-19 pandemic. The scope of the regime has been particularly widened during the last years by covering transactions carried out by European—and

notably, as of January 2023, also Italian—investors, in some particularly strategic sectors. Because of the complexities and uncertainties raised, in 2022 the procedural framework was simplified, including by establishing an investment screening unit for non-problematic transactions. In 2022, **Romania** published a proposal to expand the scope of application of its regime. In prior years, **Austria**, **Hungary**, **Latvia** and **Lithuania** expanded the powers of their authorities, as did **Spain**, which also extended certain changes introduced during the pandemic.

More transactions are being reviewed given expansions in authority and mitigated. The EU Commission's Annual Report on Investment Screening, published in September 2022 and covering 2021, states that 23 percent of decided cases entailed mitigation measures, representing a significant increase compared to 2020, with 12 percent. **France** appears to mitigate the most transactions. In its 2022 Annual Report, covering 2021, France disclosed that it mitigated roughly half the transactions it reviewed (67 of 124) and also reported a 32 percent increase in the number of filings between 2020 and 2021.

Blocks are still relatively rare and often involve Chinese investors. According to EU Annual Reports, authorities have blocked about 1–2 percent of transactions, showing that most transactions are cleared or cleared with conditions.[6] Blocks reported in the press have often involved China. For example, in the fall of 2022, **Germany** blocked two semiconductor transactions involving Chinese investors. In the spring of 2022, **Italy** annulled the 2018 acquisition by a Chinese investor of 75 percent of the shares in a military drone company, which was the fourth Italian block of the attempted acquisition of strategic assets and technologies by a Chinese investor in the last two years (Russia accounts for one of the five total blocks of acquisitions by non-European investors). As in the U.S., some investors may choose to abandon their transactions rather than have authorities block them. The EU Annual Report disclosed that three percent of transactions were withdrawn.

The EU Regulation on Foreign Investment Screening (the "Regulation"), which requires information sharing, may be strengthened. This 2019 Regulation set certain minimum requirements for Member States that operate an investment review mechanism, created a cooperation procedure to share information between the Commission and Member States, and allows the Commission to issue Reasoned Opinions to a Member State when an investment threatens the security or public order of more than one Member State or when an investment could undermine a strategic program of interest to the whole EU. While the Commission does not publish the fact of a Reasoned Opinion, the Annual Report disclosed that it issued Opinions in about 3 percent of cases, which is thought to include opinions in the semiconductor/wafer fabrication space. While Member States retain final authority to block or mitigate transactions, the Commission has been active in identifying and analyzing risks, sharing information, and acting as a convening authority for Member States. The Commission also has been working closely with the U.S., including through a **EU-U.S. Trade and Technology Council** working group. After two years of operation, the EU Commission is undertaking a review of the Regulation, which will be completed by October 2023, and a further strengthening of the Regulation and additional standards to increase convergence among national authorities seem likely.

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Authorities are expected to call in more transactions. The EU Commission is beginning to monitor transactions that have not been filed in Member States and alert national authorities.

Rest of World

Canada is increasing scrutiny and potentially expanding its authority. In March 2022, Canada issued a policy statement that it would apply heightened scrutiny to transactions involving Russian investors due to its invasion of Ukraine. Its Indo-Pacific Strategy, in a section on China, says that Canada is reviewing and modernizing its investment screening authority and will act "decisively when investment from state-owned enterprises and other foreign entities threaten [its] national security, including … critical mineral supply chains." In the fall of 2022 alone, Canada ordered Chinese firms to divest from three lithium mining companies.

Other countries continue to expand and implement review authorities. In 2022, **The Philippines** launched a new investment review mechanism. In 2022, in **Switzerland** the Federal Council presented a preliminary draft of a foreign direct investment law, which is still currently being revised and it should take more than one year before being adopted and enter into force. In recent years, countries such as **Australia**, **Japan**, **India**, **Israel**, **New Zealand**, **Norway** and **South Korea** have strengthened or created mechanisms. **Taiwan**, which has a special focus on China, also remains active.

Outbound Investment Review

Action is expected in the U.S. Congress and the Biden-Harris administration have been actively considering new ways to limit U.S. investment in China and Russia. Along those lines, there were multiple bills introduced in the last Congress to establish an outbound investment screening process. The most prominent of these proposals—the National Critical Capabilities Defense Act—passed the House in February 2022 as part of the CHIPS and Science Act, but it did not survive the conference. Meanwhile, National Security Advisor Sullivan, Secretary Raimondo and other Biden-Harris administration officials have publicly indicated that they are considering similar measures, but have not released specific details.

In 2023, there is a significant chance that Congress, the Biden-Harris administration, or both, will move forward on outbound investment regulation. In particular, the Biden-Harris administration is reportedly considering a fairly narrowly scoped EO focusing on investment in critical technologies like semiconductors, quantum computing and artificial intelligence, and could release the EO in the coming months. Meanwhile, a bipartisan group of members in the House and Senate are expected to focus on outbound investment this year as well. However, views on the specifics of any such mechanism vary widely, suggesting that the process for passing it into law could be drawn out and contentious.

Increasing focus on this issue internationally is expected. A limited number of countries currently have authority to screen outbound investment, including **Taiwan** which has broad authority with respect to investments in China and **South Korea** which has authority more narrowly focused on sensitive technology. The European Commission's 2023 work program calls for an examination of "whether additional tools

are necessary in response of outbound strategic investment controls." A draft ***German*** China Strategy prepared by the German foreign ministry provides that Germany will also "examine" the possibility of creating a legal authority to allow the government, or the EU, to scrutinize "security-critical" foreign investments by German or European companies in China.

Conclusion

With a proliferation of investment review mechanisms worldwide, corporates and financial institutions must increasingly perform due diligence and plan for multi-jurisdictional review—as they already do in the merger control context—in order to avoid such reviews delaying closing timetables. Engaging with foreign investment authorities, including government departments responsible for investment screening, for frequent investors in particular should also dovetail with their broader government affairs strategy.

[1] *See* "FDI screening killed at least 20 mergers globally totaling over USD 6bn in 2022 – Analytics," by PaRR, available at https://app.parr-global.com/

[2] In addition, while the ISU approved the acquisition of Electricity North West Limited by Redrock Investment Limited, the extensive nature of the conditions imposed on the acquirer operated as a constructive veto as the acquirer pulled out of the deal following the ISU's decision. *See* https://www.gov.uk/government/publications/acquisition-of-electricity-north-west-limited-by-redrock-investment-limited-notice-of-revocation-of-final-order/acquisition-of-electricity-north-west-limited-by-redrock-investment-limited-notice-of-revocation-of-final-order.

[3] The sectors include (i) Advanced Materials, (ii) Advanced Robotics, (iii) Artificial Intelligence, (iv) Civil Nuclear, (v) Communications, (vi) Computing Hardware, (vii) Critical Suppliers to Government, (viii) Cryptographic Authentication, (ix) Data Infrastructure, (x) Defense, (xi) Energy, (xii) Military and Dual-Use, (xiii) Quantum Technologies, (xiv) Satellite and Space Technologies, (xv) Suppliers to the Emergency Services, (xvi) Synthetic Biology and (xvii) Transport.

[4] *See* the SoS Statement for the purposes of Section 3 NSIA (the so-called Section 3 Statement): National Security and Investment Act 2021: Statement for the purposes of section 3 - GOV.UK (www.gov.uk).

[5] *See* (i) Acquisition of know-how related to SCAMP-5 and SCAMP-7 vision sensing technology by Beijing Infinite Vision Technology Company Limited: notice of variation of final order, (ii) Acquisition of HiLight Research limited by SiLight (Shanghai) Semiconductors Limited: notice of final order, (iii) Acquisition of Pulsic Ltd by Super Orange HK Holding Ltd: notice of final order and (iv) Acquisition of Newport Wafer Fab by Nexperia: notice of final order.

[6] Five Member States, namely Austria, France, Germany, Italy and Spain, were responsible for 70 percent of transactions reported to the Commission, down from 85 percent. See EU Annual Report.

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