All about security? What 'de-risking' in the EU and UK means for foreign trade and M&A transactions

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De-risking is currently a very popular term among politicians, economists and security experts. In a way, it is the lowest common denominator in the debate about how to deal with hostile states such as China in the future and, more broadly, how to reduce economic dependency on non-domestic actors (be those hostile states, large corporate conglomerates or GAFAM[1]) and increase supply chain resilience in the face of geopolitical uncertainty. But the precise definition of de-risking, despite the distinction from decoupling, remains largely fuzzy. The strategy focuses on scrutinising foreign direct investment, tightening export controls, protecting critical infrastructure and reducing dependence on critical raw materials.

From a business perspective, it raises questions about the potential impact on operations and on M&A. Which sectors will be in focus? What exactly will the risk analyses look like? What restrictions can be expected in the future? How interventionist will governments be?

A shift in foreign trade policy and regulation

Foreign trade regulations have long been central to the security architecture of western countries. Averting threats to national security and public order is the main objective of those existing regulations. Exports of military equipment or goods that could be used for military purposes and investments by foreign companies in European industries have long been the focus of attention. A nation-state perspective has usually shaped the concept of threats to public security. Investment reviews for the control of foreign investment in critical industrial sectors, as well as restrictions on the export of sensitive goods, were primarily for the protection of national security interests. Investors from third countries were to be given no access, or as little as possible, to national defence technology or critical infrastructure. Conversely, if the use of goods and technologies could endanger national security interests, European companies were not to export them to third countries.

However, the increasing paradigm shift in foreign trade law that has been in play for several years is now illustrated by the European Commission's recently published European Strategy for Economic Security, the German Government's China Strategy and the UK Government's 2023 Integrated Review Refresh (of Security, Defence, Development and Foreign Policy).[2] The UK Government commissioned the Integrated Review Refresh to respond to emerging geopolitical threats and to set out how it proposes to 'tackle new threats from Russia and China' specifically, and a main conclusion of the review is that the current global security situation will deteriorate further if democracies such as the UK and EU do not do more to build resilience and to cooperate and compete against those driving instability.

The central instruments of foreign trade law – investment assessment and export control – will now focus not only on security issues but also on geostrategic interests. The juxtaposition between being more alert and responsive to the threats of hostile nations and actors, while at the same time being more invested in and focused on relationships with other actors, will be for businesses to navigate in the context of the increasingly robust reviews and controls implemented through these foreign trade instruments.

Expanded foreign investment screening in Europe

Many EU Member States have significantly expanded and tightened their foreign direct investment screening requirements since the introduction of European investment screening requirements through the EU Screening Regulation.

There are now notification and approval requirements for acquisitions in a wide range of industries in almost all EU Member States. In addition to existing obligations for investments in security, defence and critical infrastructure, new areas include medical devices, robotics, artificial intelligence, autonomous driving, IT security, cloud computing, semiconductors, critical commodities and agribusiness.

The German Federal Ministry for Economic Affairs and Climate Protection recently announced a proposal for a new law that will introduce significant changes to the existing regime, including the introduction of new categories of sensitive industries (for example, chips, AI and minerals),

1 Google, Apple, Facebook, Amazon and Microsoft.

2 UK Government Policy Paper, 'Integrated Review Refresh 2023: responding to a more contested and volatile world' (13 March 2023, updated 16 May 2023). Available at:: 11857435_NS_IR_Refresh_2023_Supply_AllPages_Revision_7_WEB_PDF.pdf (publishing.service.gov.uk).

lower review thresholds and even a revised burden of proof for particularly sensitive investments, requiring the investor to prove that the investment will not endanger public security. Furthermore, it is explicitly provided that the background of a (potential) acquirer may also justify an impairment of national security interests. Based on this, the Member State authorities responsible for assessing the investment can in many cases also examine whether the acquisition of a minority stake by investors from outside the EU would affect security interests. The recent decision of the European Court of Justice in the *Xella* case[3] does not change this, although Member States must take account of the fundamental freedoms of EU law in their assessment.

The UK's broad National Security and Investment Act

Across the Channel, the UK Government has also significantly increased the scope of its national security regime through the National Security and Investment Act 2021. This new standalone regime has strengthened the UK's powers to scrutinise investments on the grounds of national security, and the UK Government sees it as a key practical step to improving the UK's economic, health and energy security.

The extensive new regime clearly supports the UK's expanded approach to security as, from a target perspective, it covers not only defence, military and dual-use activities, but also a broad range of other critical infrastructure and sensitive technologies through the designation of 17 broad sectors of the economy. Certain levels of investment in entities active in the 17 sectors trigger mandatory and suspensory notification to the newly established Investment Security Unit, within the Cabinet Office, with potential criminal and civil sanctions for failure to obtain the approval of the Deputy Prime Minister. It is even more broad in its approach to identifying and assessing potential threats by reference to the nationality of the acquirer, as there is no exemption for non-sensitive acquirers and even acquisitions by UK buyers are caught.

Its broad scope does not end there, as it also includes a voluntary regime which provides the UK Government with the ability to call in for review transactions (including minority investments and even asset acquisitions) in *any* sector of the economy where there is a potential risk to national security. The first year and a half of practical enforcement of the regime has demonstrated that it is not just a broad instrument available to deploy in exceptional cases, but rather that the UK Government has the appetite to take strong action to prevent and intervene in what it considers to be risky investment in critical infrastructure and sensitive technologies.

Experience shows that the combination of the (potential) sensitivity of the activities of the target undertaking, the background and ties of the buyer and the current political situation in the industry are key factors in the approval of a takeover in Europe. Where security concerns arise, prohibition is possible and there are also a range of other mechanisms available to governments to use in intervening to address security risks. An increasingly popular option in the UK appears to be the requirement to have a government-appointed observer on the board of the target company, to keep close watch.

Developments of other instruments in the EU and UK foreign trade toolboxes

Export controls, traditionally used to protect against the proliferation of weapons of mass destruction and the uncontrolled use of dual-use technologies for military purposes, are undergoing a similar development. As part of its security strategy, the European Commission has now announced that export control regulations will in future be used even more effectively for the protection of 'strategically important technologies'. This means explicitly extending the aims of controlling exports to include protecting geostrategic interests. The Commission intends to present a proposal to improve the effectiveness and efficiency of the current export control framework by the end of 2023 at the latest.

Competition and merger control policy in Europe has also explicitly added 'market resilience' to its focus, as competition authorities explore their roles in ensuring that markets 'meet the needs of people, businesses and the wider economy in both stable and unstable times'. Consistent with expanding security strategies and increased intervention in Europe through foreign investment tools, the Commission and UK Competition & Markets Authority (CMA) are both increasingly eager to expand the reach of their already robust merger control reviews where M&A transactions which give rise to perceived competition problems fall below the jurisdictional thresholds and thus escape regulatory scrutiny.

Most starkly, in March 2021 the Commission published guidance to encourage national competition authorities to refer transactions to it even where they do not meet the national merger control thresholds of the Member State. This marked a stark change in policy and appetite for intervention from the Commission which previously had a longstanding practice of discouraging such referral requests where national competition authorities themselves did not have jurisdiction, and was driven by a perceived gap in enforcement in relation to 'killer acquisitions' of nascent businesses. The increased practical reach of the Commission has been criticised for degrading legal certainty and poses an ongoing risk for M&A transactions, which may be scrutinised – for the best part of a year or more – and potentially ultimately required to be rescoped or even prohibited, despite not being within scope of any national or EU merger control thresholds. This change in policy was upheld by the EU General Court in July 2022 in relation to the Commission's review and prohibition of biotech company Illumina's acquisition of GRAIL,[4] an innovative developer of a cancer detector test with no revenues in Europe, and so is an additional mechanism of scrutiny for M&A which is here to stay.

The mood in the UK is similar. Despite the known flexibility of the existing UK jurisdictional tests, the CMA considers competitive markets to be key to the health of the UK's economy (and therefore security) and is of the

3 Case C–106/22. Judgment of 13 July 2023.

4 Case T–227/21. EU General Court judgment 13 July 2022.

view that there are a range of transactions which give rise to potential competition concerns that it does not have jurisdiction to scrutinize, for example, some vertical mergers and 'killer acquisitions'. The UK Government is therefore seeking to introduce a new threshold which will give the CMA the ability to review M&A deals with a UK nexus where one party alone meets certain thresholds, without the need for the parties to have overlapping (competing) activities in the UK or elsewhere.

GAFAM and other businesses in digital markets also have new specific competition rules to take into account in each of the EU and UK, with additional merger control filing requirements applicable to certain designated digital technology businesses.

Additionally, the Commission may now under the newly enacted Foreign Subsidies Regulation review transactions in which the target and/or the acquirer have been (substantially) subsidised by non-EU governments.

The new kid in town – outbound investment screening

An entirely new development could also occur in the area of outbound investment screening, that is, the screening of outward investments into foreign countries. Following the example of the US administration – which is focused on ensuring that China does not benefit from US technology and capital – the Commission has proposed the introduction of a set of tools to monitor and, where appropriate, restrict EU investment abroad in highly sensitive industries, in addition to existing export controls. The Commission intends to present an initiative by the end of 2023 and has announced further discussions with Member States and stakeholder consultations. Some Member States have been discussing similar plans for some time. Whether they will leave the initiative to the EU or pursue their own plans in parallel remains to be seen.

The UK Government has also indicated that it is consulting on and considering the new US measures closely, and the UK Prime Minister is reported to have promised the US President that the UK would respond effectively to ensure UK capital and expertise is not used to the benefit of rival states.

Key takeaways for M&A

Finally, while monitoring initiatives and regulatory hurdles have been enhanced, and are expected to be an ongoing focus area, the number of prohibitions and/or interventions in the EU and UK remains relatively low as compared to the total number of foreign investments reviewed and carried out, which is no doubt reassuring to international investors, even in the face of sometimes significant delays to deal timelines. Eurostat and OECD reports also suggest that the extent of Europe's relationship with China and other actors has not (yet) been negatively impacted.

That is, however, not to say that regulatory approvals and the implications of potential interventions should not form an important part of investment strategy considerations now and in the future. They should be carefully and strategically considered in the context of negotiating M&A transactions, including sometimes to a party's material advantage in competitive bid scenarios, and are expected to only continue to grow in importance.

Foreign trade law is not being reinvented in the recently published security strategies. Rather, those strategies for the most part call for better and more robust application of existing and expanded controls. It is, however, to be expected that implementing such a strategy in EU Member States and the UK will not only entail changing administrative practice but also a further tightening of existing regulations. Overall, the current draft of the Economic Security Strategy and the UK's Integrated Review Refresh are therefore likely to be only the beginning of a comprehensive geo-economic debate on the future reorientation and recalibration of foreign economic policy and legal instruments. In the meantime, perhaps (at least certain) international investors can take comfort from the notion that remaining open for business, and developing strategic international relationships, is undoubtedly an important part of ensuring wider economic growth and security in Europe.