Foreign investment and national security review in M&A

A significant regulatory trend to watch in 2014 is how governments treat foreign, and particularly state-owned, investors, as well as investments in strategic sectors.

Focus on Canada

Over the past year, the Canadian government has established new rules restricting and monitoring investments by foreign state-owned enterprises (SOEs) in Canada, indicating concerns about the prospects of foreign nationalization (following decades of privatization of Canadian state ownership in key sectors of the economy). The acquisition by Chinese SOE, CNOOC, of Canadian oil and gas company, Nexen, in early 2013 was approved by the government but triggered a public debate about the role of SOEs and ultimately resulted in a Canadian government policy that, going forward, prohibits SOEs from acquiring control of oil sands projects save in exceptional circumstances. The government also served notice that it would be monitoring SOE investments in other areas of the economy, and in particular would closely scrutinize SOE acquisitions in sectors where SOE investment was becoming significant. The new and tougher approach to SOEs was bolstered by amendments to the Investment Canada Act which broaden the definition of an SOE beyond foreign state ownership to include an entity "influenced" by a foreign government and expand the circumstances in which an SOE investment can be reviewed.

Apart from articulating a policy that could limit SOE investment in the Canadian economy, the government has demonstrated its willingness to block private foreign capital in key sectors such as telecommunications for national security reasons. The rejection of Egyptian-controlled Accelero Capital Holding's purchase of Allstream— the wireline enterprise services division of Manitoba Telecom Services Inc. (MTS) in October 2013 under the little-used and relatively new (2009) national security review law signalled the government's sensitivity to investments in critical and strategic areas of the economy such as telecommunications infrastructure.

Focus on US

Notifications and reviews of inbound foreign investment transactions by the Committee on Foreign Investment in the US (CFIUS) to determine whether they impair "national security" have dramatically increased in the last two years, and 2014 promises to be no different. In the most recent statistics reported by CFIUS (for 2012), 114 deals were reviewed by the Committee, with more than 40 percent of those deals being fully investigated by the Committee. CFIUS has the authority to review transactions involving a wide range of foreign investment into the United States, particularly those that involve foreign government investment (such as State-Owned Enterprises) and any investment in critical infrastructure. CFIUS is comprised of representatives from nine different departments and agencies within the Executive Branch of the U.S. government (including Commerce, Defence, Homeland Security and Justice) and is overseen by the US Treasury Department. "National security" is purposefully left undefined in the law creating CFIUS and in the implementing regulations published by CFIUS, so that "national security" can be interpreted in accordance with political exigencies.

While notifications to CFIUS of foreign investment transactions are not mandatory, once there is a required notification to one US government agency (i.e., an HSR filing) for a proposed transaction, a voluntary filing with the CFIUS agencies may well be advantageous. The benefit of notifying CFIUS of a proposed transaction is that, after CFIUS has cleared the transaction, the acquiring company has assurance that the transaction will not be investigated and possibly challenged after closing. A notification to CFIUS is essentially an insurance policy against post-closing U.S. regulatory review on "national security" grounds. The CFIUS process may require 30 days, or 75 days if CFIUS initiates a 45-day investigation (in addition to the initial 30 day review).

The CFIUS review process has again been the subject of high profile political and legal maneuvering. In 2012, for the first time in more than 20 years, the President blocked a proposed transaction -- the construction and operation of a wind energy facility by a consortium of investors from China -- on grounds of national security. Our experience over the past year suggests that the CFIUS agencies continue to apply a strict standard to investments in the energy sector, as well as those that involve proximity to US Defense installations, and presage an increase in the number of reviews that go through the full 75-day process and require mitigation measures before approvals are issued.

Focus on China

The Chinese central government has decided to simplify approval procedures and delegate approval authority for foreign investments. The principle is that unless there is a concern about national security, ecological security, production of material industries, development of strategic resources and material public interests, investments will be exempted from governmental approvals. In the past year, the Chinese government has increasingly relaxed its control over foreign investments. In addition, capital controls are likely to be further eased in the future.

A key development regarding foreign investment is the unveiling of China's first free trade zone, which opened in Shanghai in October 2013. The plan, which will take three years to fully implement, is the latest step in China's national strategy to further open up markets and promote Shanghai as an international trade and financial hub. China released a negative list of the restricted and prohibited sectors for foreign investment, which covers 18 sectors ranging from agriculture to manufacturing to finance to public services. For sectors beyond the negative list, foreign enterprises registered in the free trade zone may invest as freely as their domestic peers. The negative list will be updated every year and will be shortened as negotiation of bilateral investment treaties with the U.S. and European Union make progress.

China has also announced that it will be amending its three major laws to relax the rules on foreign-investment enterprises. In addition, China's State Administration of Foreign Exchange (SAFE) has simplified the process of settling international service-related payments. The new rules apply to service-related payments, such as service fees, advances and expense reimbursements, with a general principle of looser regulatory restrictions on service-related payments that are based upon genuine and lawful transactions. SAFE's statistics show that the new rules apply to around 80% of the service related payment and has enhanced the efficiency of a substantial amount of foreign exchange payments in the service sector.