Takeover Bids in Europe in Times of a World-wide Pandemic Threat: A Delicate Balance Between the Fundamental Freedoms and the Protection of Europe's and the Member States' Strategic Assets

by

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This paper explores takeover bids in Europe in times of the COVID-19 pandemic. The search for a balance between maintaining the open market as a European achievement and the protection of national security and public order is not a new phenomenon. This search is not easy with the future FDI Regulation and will raise additional questions. The FDI Regulation became very concrete thanks to the COVID-19 pandemic. At the beginning of the crisis, the Commission presented a Communication setting out guidelines for FDI to be applied prior to the regulation.

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1. Europe's Tradition of Open Markets

1. Europe is built on open markets: according to the preambles of the TFEU¹, the member states are, among other things, "resolved to ensure the economic and social progress of their States by common action to eliminate the barriers which divide Europe", "recognising that the removal of existing obstacles calls for concerted action in order to guarantee steady expansion, ba-

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¹ On the free movement of goods, see art. 29: goods coming from a third country are considered to be in free circulation in a member state when custom duties or charges having equivalents effect have been levied.

lanced trade and fair competition", and "*desiring to contribute, by means of a common commercial policy, to the progressive abolition of restrictions on international trade*" (we underline). The freedom of establishment (art. 49 TFEU), though only granted to nationals of other member states or to companies within the meaning of art. 54 TFEU³, can however be restricted for reasons of public policy, public security or health. The TFEU does not provide for a separate treatment of third parties, but one can rather safely state that in most European countries, it is or at least was not too difficult for the incumbent of a third country to incorporate or to invest in a company established on European soil, which would as of its incorporation be protected under the right of free establishment. In the same vein, art. 63 TFEU proclaims that no restrictions are allowed on the movement of capital between member states or between member states and third countries. To put it differently, for those who would for whatever reason not be able to incorporate a company on European soil, not being a European national, they should without too many difficulties be able to invest in an existing company. Art. 65 (1) (b) makes an exception only if public policy or public security (and not health) is at stake (15 member states (including the UK) have already done so⁴; some other are considering similar initiatives⁵). In all other cases, the companies owned or controlled by shareholders from third countries enjoy the right of free establishment just as any company owned or controlled by shareholders from a European member state would do.

We should cherish this tradition of openness. The post second world war generation in Europe has profited immensely from the open market economy and the globalization of trade, but also of culture, science, and education. At the same time, we need to recognize the challenges that come along with it, and I only name a few: a pressure on the earth that it may at a certain point no longer support⁶. A growing inequality causing massive inflows of refugees on the macro-level (specifically hitting Europe, as it is relatively easily accessible to a large part of the Middle East and Africa, where the globalization has only aggravated pre-existing political and economic tension and increased the pressure on the natural resources). And, more on the micro-level, a growing gap be-

- 2 Being companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the EU; there is no requirement of a presence of nationals of a member states, let alone of a meaningful number of them.
- 3 A full overview with references and links is available at https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf (last accessed 15 July 2020).
- 4 Which does not necessarily imply that all of these restrictions respond to the concerns identified by the European Commission.
- 5 And, other than some people may think, I fear it is not humankind but the earth itself that will win this battle, if ever we do not manage to find a new and reasonable balance.

tween that part of the European population that until today experiences the benefits of being part of Europe and even of the world, and that other part that feels more and more at a loss, because they do not have the capabilities to create a decent level of income in this "brave new world" (after A. Huxley) nor are taught new and badly needed new capabilities in this rapidly changing environment. These people risk becoming the easy victims of those who claim that in the past everything was simpler, and therefore by definition better. And in the past Europe was a mere continent, not a Union. We should definitively not go back there. Europe is, rightfully so, in seek of balances.

2. Indeed, not only barriers among member states (or, more broadly, the countries belonging to the EEA) but also barriers towards third parties not belonging to the EU or the EEA are in scope: Europe was and still is one of the most open economies of the world⁶, and, even more importantly the number of foreign direct investments ("FDI") in Europe is growing over time. According to an analysis made by the European Commission dating from the spring 2019 and set up in the framework of the preparation of the FDI Regulation⁷, only a very low 3 percent of European companies in the sample considered in 2016 were owned or controlled by non-EU investors, but these 3% represented more than 35 percent of total assets in the sample and around 16 million jobs⁸. The what the European Commission calls "traditional" main investors in the EU, being the US, Switzerland, Norway, Canada, Australia, Japan, in the same 2016 sample still controlled more than 80 percent of all foreign-owned assets, and they invested in a very diverse range of activities, notably the US. However, that same sample showed that emerging economies such as China and India are taking up a bigger chunk of FDI and, maybe even more importantly, their focus is much less diversified: in 2016 the interest of China in aircraft manufacturing and specialised machinery was apparent, and India clearly focused on pharmaceuticals. What the Commission found

- 6 See also, announcing this report, the Communication from the commission to the European parliament, the European council, the council, the European economic and social committee and the committee of the regions, "Welcoming Foreign Direct Investment while Protecting Essential Interests", Com(2017) 494 (final), 13 September 2017 (<https://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-494-F1-EN-MAIN-PART-1.PDF>) and, earlier, the "Reflection Paper on Harnessing Globalisation", COM(2017) 240, 10 May 2017 (https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-globalisation_en.pdf).
- 7 Regulation (EU) 2019/452 of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union.
- 8 European Commission (2019) Staff Working Document of Foreign Direct Investment in the EU, SWD(2019) 108 final, 13 March 2019 (https://trade.ec.europa.eu/doclib/docs/2019/march/tradoc_157724.pdf). It is noteworthy that the Commission itself admits the absence of reliable data to measure FDI in 2016.

even more striking was the fact that “offshore investors” controlled 11 percent of foreign-owned EU companies and a significant share of foreign-owned assets (4 percent) in the EU.

According to the same report, FDI is widespread across virtually all sectors of the EU economy, but it is remarkably high in a number of pivotal sectors: oil refining (67 percent of total assets of the sector), pharmaceuticals (56 percent), electronic and optical products (54 percent), insurance (45 percent) or electrical equipment (39 percent). Finally, state-owned companies represent only a small proportion of foreign acquisitions, but their share in the number of acquisitions and their assets are increasing at notable speed. The Commission cites the example of Russia, China and the United Arab Emirates having tripled the number of their acquisitions in 10 years (18 in 2017, 9 in 2007). Over the same period foreign investment funds and private equity firms (mostly, and in that order, from the US, followed by the Cayman Islands and Switzerland) have almost doubled their acquisitions in Europe (from 102 in 2007 to 194 in 2017). Remarkable is finally the rise of individuals holding mainly Swiss, US, Russian, Norwegian and Chinese passports as ultimate owners: while they represent only 5 percent of the total number of deals, between 2007 and 2017, the number of acquisitions involving individuals or families has increased from 31 to 197.

These numbers are interesting enough, but 2016 is an eternity ago. Particularly the qualification of the current US as a “traditional investor” with a diverse focus on European investments, and the one of China as an emerging economy may be topics for discussion or at least can use some nuance today.

II. The FDI Regulation

3. The Reflection Paper, the Communication and the SWD on FDI cited above (n° 2) were pre-announcing Europe’s search to the balance between maintaining an open market, but at the same time protect national security or public order. Below I briefly summarize the rules embedded in the FDI Regulation, which shall apply as of 11 October 2020. As will become apparent, the search for the balance is not easy, and will bring along additional questions.

4. Important to note is that the FDI Regulation starts with the continued acknowledgment that FDI “contributes to the Union’s growth by enhancing its competitiveness, creating jobs and economies of scale, bringing in capital, technologies, innovation, expertise, and by opening new markets for the Union’s exports” (preamble 1). Also, the FDI Regulation does not prevent member states to make use of their right under art. 65 (1) (b) TFEU to derogate from the free movement of capital in order for reasons of public policy or public

security (preamble 4) (see n° 1), nor does it create any prejudice to the sole responsibility of member states to safeguard their national security as provided for in art. 4 (2) TFEU, or to the protection of their essential security interests in accordance with art. 346 TFEU (preamble 7). However, the FDI Regulation strives at creating some coordination in these national initiatives (preambles 7 and 8). Moreover, when it comes to the common commercial policy, art. 3 (1) (e) TFEU does give the EU exclusive competence, as preamble (6) recalls.

That brings us to the scope under art. 1: (i) screening by member states of foreign direct investments (i.e. investments by a natural person or an undertaking of a third country) on the grounds of security or public order and (ii) a mechanism for cooperation between member states and between member states and the Commission. The latter includes the possibility for the Commission to issue opinions on FDI, but as set out above, its national security and to protect its essential security interests remain the member state’s sole responsibility.

An investment only qualifies as a FDI when it aims at establishing or maintaining “lasting and direct links” between the foreign investor and the entrepreneur or the undertaking concerned carrying on an economic activity thanks to that investment, including “enabling effective participation in the management or control of a company” (art. 2)⁹. To be noted that these notions are not further defined, and no indication as to the exact meaning thereof is not given in the preambles either. Furthermore, screening includes “assessing, investigating, authorising, conditioning, prohibiting or unwinding” FDI (art. 2).

Art. 3 lays out the basic rules for the screening mechanisms that can be set in place by the member states, and actually are already present in 15 (soon 14) member states (see n° 1). Any existing mechanisms had to be notified to the Commission by 19 May 2019, and any new or amended mechanisms have to be notified within 30 days.

Interesting are the factors enumerated in art. 4 (1) that either member states or the Commission can take into consideration for their screening, because it makes the notions “security” and “public order” a bit more concrete:

- critical infrastructure, whether physical or virtual, including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure;
- critical technologies and dual use items as defined in point 1 of Article 2 of Council Regulation (EC) No 428/2009 (15), including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, en-

9 Preamble (9) clarifies that portfolio investments are not covered by the FDI Regulation.

- energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies;
- supply of critical inputs, including energy or raw materials, as well as food security;
- access to sensitive information, including personal data, or the ability to control such information; or
- the freedom and pluralism of the media.

This enumeration is not exhaustive (see also preamble 12).

Moreover, according to art. 4 (2), the following elements – again illustrative – can also be considered in order to determine whether a FDI may affect security or public order:

- whether the foreign investor is directly or indirectly controlled by the government, including state bodies or armed forces, of a third country, including through ownership structure or significant funding;
- whether the foreign investor has already been involved in activities affecting security or public order in a Member State; or;
- whether there is a serious risk that the foreign investor engages in illegal or criminal activities.

Also worth paying some attention to is the cooperation mechanism of the FDI Regulation, as laid down in art. 6 and 7. In short, any member state that proceeds to a screening must notify both the Commission and the other member states, indicating, if possible, which other member states may also be affected by the FDI. The information to be provided is listed in art. 9 (2), and if possible the member state must also indicate whether EU concentration control will also apply. The Commission is entitled to issue an opinion within the meaning of art. 288 TFEU when it considers that more than one member state may be affected, and must issue an opinion if at least 1/3 of the members states considers it is likely to be affected. A detailed timeframe is set out for the exchange of information and opinions, but if a member state considers that immediate action is required, it must duly notify the Commission and the other member states, that will then try to react in an expedient manner. If a member state considers that a contemplated FDI in another member state that is not undertaking any screening may affect its security or public order, it can notify such other member state and the Commission thereof. The Commission can and shall issue an opinion under the same conditions as the ones set out above. The member state that was not taking any initiatives towards an FDI shall take any comments of other member states as well as any opinion of the Commission in due consideration.

The FDI Regulation will have an impact as of 20 April 2019 on FDI's that did not undergo any screening: member states may, as of 20 October 2020, provide comments and the Commission may provide an opinion up to 15 months as of completion of the unscreened FDI (art. 7(8)). This may bring the member state concerned to still take action.

Finally, when the FDI is, in the view of the Commission, likely to affect projects of programmes of the EU itself, it may also issue an opinion. These include projects and programmes that involve a substantial amount or a significant share of EU funding, or that are covered by EU law on critical infrastructure, critical technologies or critical inputs as annexed to the FDI Regulation. The member state concerned must this time take utmost account of the Commission's opinion, and, the case being, explain to the Commission why its opinion is not followed.

III. The Guidance "ahead" Following the COVID 19 Pandemic

5. The FDI Regulation all at a sudden became very concrete thanks to the COVID19 pandemic: on 25 March 2019, very early in the pandemic, the Commission made a communication whereby it provides guidance on FDI "ahead of the application of" the FDI Regulation entering into force on 11 October 2019¹⁰. The healthcare capacities, such as the production of medical or protective equipment so badly needed, or the research for a vaccine against COVID 19, even more badly needed, became an immediate concern, as it also became clear that Europe was hardly able to produce what it needed, and that the world wide run on the vaccines would be merciless, and risks to be largely dominated by the financial gain. The example was too obvious not to seize the occasion: the Commission encourages the member states that already have FDI-screening in place to fully make use of it in these fields, and those that do not have them yet to put them into place. The latter is not so evident: member states' governments have had their hands full up until now in coping with the health crisis, and such a screening system is not drafted, approved and up and running in a couple of days.

The Commission also points out that if a FDI has not undergone any screening, member states and the Commission are entitled to provide comments re-

¹⁰ Communication from the Commission – Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation), C(2020) 1981 (final) ([https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52020XC0326\(03\)](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52020XC0326(03))).

spectively an opinion up until 15 months after the FDI has been completed, as of 19 April 2019 (see n° 4). Practically speaking these comments or opinion may lead to an ex post intervention of the member state where the FDI took place as of 11 October 2020, and until 11 January 2022 at the latest. In other words, the Commission seems to deliberately create a feeling of legal insecurity for foreign candidates not undergoing any screening yet.

As also set out above, portfolio investments are not covered by the FDI Regulation. In its Communication the Commission reminds member states and potential investors of the right of member states to verify the compliance of an investment with the free movement of capital, and specifically with its limits under art. 65 (1) (b) TFEU, such as public health, as well as the possibility to take measures under art. 66 or 143 and 144 TFEU in exceptional circumstances.

IV. The Takeover Bid Practice and the Screening of FDI

6. At a more specific level, a similar openness characterizes the Takeover bid directive¹¹. Its preambles speak for themselves in this respect, or rather, they do by remaining silent on third country offerors: "it is necessary to protect the interests of holders of the securities of companies governed by the law of a Member State when those companies are the subject of takeover bids or of changes of control and at least some of their securities are admitted to trading on a regulated market in a Member State" (preamble 2); "in order to prevent operations which could frustrate a bid, the powers of the board of an offeree company to engage in operations of an exceptional nature should be limited, without unduly hindering the offeree company in carrying on its normal business activities" (preamble 16); "in order to reinforce the effectiveness of existing provisions concerning the freedom to deal in the securities of companies covered by this Directive and the freedom to exercise voting rights, it is essential that the defensive structures and mechanisms envisaged by such companies be transparent and that they be regularly presented in reports to general meetings of shareholders" (preamble 18); "member states should take the necessary measures to afford any offeror the possibility of acquiring majority interests in other companies and of fully exercising control of them. To that end, restrictions on the transfer of securities, restrictions on voting rights, extraordinary appointment rights and multiple voting rights should be removed or suspended during the time allowed for the acceptance of a bid and when the general meeting of shareholders decides on defensive measures, on amendments to the articles of associa-

tion or on the removal or appointment of board members at the first general meeting of shareholders following closure of the bid. [...]" (preamble 19). There is one exception: preamble 20 provides that "all special rights held by member states in companies should be viewed in the framework of the free movement of capital and the relevant provisions of the Treaty. Special rights held by member states in companies which are provided for in private or public national law should be exempted from the 'breakthrough' rule if they are compatible with the Treaty" (we underline). To be fair, we must briefly mention that thanks to the opt out allowed under art. 12 of the Takeover bid Directive, about 40% of the member states do not have a board passivity rule, and about 95% do not have a breakthrough rule anyhow¹², but that does not change the conclusion: an offeror originating from a third country does not encounter many obstacles when desiring to take control of a European company.

This will drastically change upon the entry into force of the FDI Regulation, certainly for those member states – about 50% – that do not yet have FDI restrictions in place. The Commission found that in 2016 9.3 percent of listed companies have a non-EU owner, compared with 2.8 percent of the unlisted companies and non-listed public companies. 45 percent of the total assets of listed companies and 33 percent of the total assets of non-listed companies were controlled from outside the EU (the non-EU controlled entities generally being much larger. However, the share of non-EU controlled companies in the total number of firms would have been rising only for listed firms, while the share of non-EU controlled entities in terms of assets would have been increasing for both listed and non-listed entities¹³).

It is quasi-certain that all relevant information on non-listed entities is not will become readily available – UBO-notification will surely be helpful, but is coming after the facts – which may distort the figures. It does not mean that FDI's may be less present, relevant or important in non-listed entities, to the contrary.

On the other hand, it is certain that the information on contemplated FDI's will continue to be more readily available for listed entities. So we can expect to learn first from the listed entities. If a member state has a screening procedure into place, it would best include this screening in its timetable for a take-

12 9 out of 22 respectively 21 out of 22 (see *Marcus Partners and Mazars*, The takeover bids directive assessment report, April 2013, 388–389 (<https://op.europa.eu/en/publication-detail/-/publication/67501b75-7583-4b0d-4551-33051d8627c1>) (last accessed 15. July 2020).

13 See the SWD cited in footnote (8). The information provided does not allow to define "ownership" or "control", nor whether this only concerns entities the securities of which are listed on regulated markets. The Commission is fully aware thereof.

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