Linklaters

Getting over the line.

Clearing regulatory hurdles to outbound M&A

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Contents

This report is an updated version of the paper that was written for release at the China Development Forum, which took place in March 2017 in Beijing. This updated version reflects events between March 2017 and July 2017.

Executive Summary

> China is playing an increasingly significant role in outbound mergers and acquisitions (“**M&A**”), with approximately $220bn of Chinese outbound M&A deals announced in 2016.

> However, a considerable number of deals are also being blocked by regulatory authorities, or withdrawn by potential investors ahead of anticipated blocks. Analyst commentary suggests approximately $40 - 75bn worth of Chinese outbound deals were blocked or withdrawn in 2016.

> While the pace of outbound deals has declined in 2017, China’s long-term aspirations as evidenced by initiatives such as Made In China 2025 and the Belt & Road Initiative means that outbound investment and acquisitions from China will continue to be a significant force over the long-term. We estimate, from synthesizing analyst and official forecasts, that Chinese outbound investment flows may come to $1.5 trillion over the next 10 years.

> Reasons relating to national security or national interest have been behind many of the higher profile withdrawn deals. How to anticipate and deal with these concerns (as well as other hurdles which may be of a softer nature) is key.

> Concerns relating to “reciprocity” (that is, the mutual openness of economies to foreign direct investment) are also driving political discourse on the regulation of overseas direct investment, especially into Europe.

> There are several cross-jurisdictional trends that should be considered in getting deals through regulatory scrutiny and governmental concerns. As further described in this report, these include:

– the evolving nature of national security and strategic concerns;

– the complexity of domestic sector regulation and public opinion including domestic perceptions of Chinese investors;

– the importance of timing, driven by the effects of the two points above as well as regulators and governments seeking to appropriate or exercise more power to veto acquisitions;

– the benefits of capitalising on Chinese acquirers’ global reach;

– increased regulatory scrutiny requiring early and open engagement with the relevant authorities;

– the unique risks posed, and mitigants required, by the Chinese regulatory approval process;

– the need to deal with sequencing and inter-relation of regulatory strategies in complex multi-jurisdictional transactions; and

– the challenge, posed by increasing concerns over reciprocity (especially in Europe), for China to liberalise its markets in parallel with other jurisdictions and economies.

> We recognise and commend the Chinese government’s continuing efforts to support Chinese businesses in executing successful outbound M&A. Initiatives such as business education programmes and the use of China’s diplomatic network to help Chinese businesses build local networks, continue to be very helpful in educating Chinese business leaders of the challenges and opportunities they will need to consider in going global.

Chinese outbound investment flow may reach
$1.5tn
over the next 10 years

Introduction

In 2016, China had a leading role in cross-border deal making: Chinese outbound M&A has been estimated in press reports at approximately $220bn in 2016, double the level of approximately $110bn in 2015. However, as the volume of deals and the range of Chinese and Chinese-controlled entities involved have increased, the scrutiny of these deals by domestic and international regulators has sharpened significantly, resulting in several high-profile deals being delayed or cancelled (often for concerns relating to security or national interest). Press reports and analyst commentary indicate that in 2016 Chinese outbound deals worth tens of billions of dollars were blocked or withdrawn across the world: estimates range from approximately $40-75bn, depending on the source and assumptions used.

Admittedly, Chinese outbound deal flow has fallen in 2017. This may be partially in response to greater scrutiny of outbound investment from China by Chinese regulators. Recently the China Banking Regulatory Commission has asked Chinese banks to consider their level of exposure to some of China's most prolific acquirers of overseas assets.[1]

Nevertheless, while the pace of outbound deals has declined in 2017, China's long-term aspirations as evidenced by initiatives such as Made In China 2025 (which aims to significantly extend and enhance China's manufacturing capabilities, especially in high-tech industries) and the Belt and Road Initiative (which aims to invest significant amounts into international connectivity, infrastructure and trade routes) means that outbound investment and acquisitions from China will continue to be a significant force over the long-term.

For example, a recent estimate from the Vice-Chairman of China's National Development and Reform Commission (an economic agency under the Chinese State Council) projected $600bn to $800bn of overseas investment flows from China over the next five years.[2] To take a further example, more than $900bn of investments have been announced across 65 countries in connection with China's Belt and Road initiative: "arguably the largest overseas investment drive ever launched by a single country".[3]

These high projected levels of investment mean that Chinese outbound will remain a highly significant force in overseas investment over the long-term, even if levels oscillate from one year to the next. Indeed, even the lower level of deal flow in the first half of 2017, Chinese outbound M&A activity "is still on track to be the second highest full year on record."[4] We estimate, from synthesizing analyst and official forecasts, that Chinese outbound investment flows may come to $1.5 trillion over the next 10 years.

$40-75bn
worth of Chinese outbound deals were blocked or withdrawn in 2016

$220bn
of Chinese outbound M&A deals announced in 2016

1 Source: Bloomberg, 22 June 2017
2 Source: Reuters, 12 May 2017
3 Source: Financial Times, 4 May 2017
4 Source: Financial Times, 29 June 2017

Initiatives such as Made In China 2025 and Belt and Road mean that this high level of outbound investment is likely to be focused on sectors such as high-end technology, infrastructure, and other sectors that may be seen as "strategic" to national security or national interest. Indeed, regulatory concern at foreign investment often relates to the sector of the acquisition target. Many of the delayed or withdrawn deals are in sectors considered by the host government as being "critical" or "significant" to national security or national interest. This includes sectors such as:

> energy infrastructure (e.g. the blocking of the acquisition of Ausgrid in Australia);

> high-end technology (e.g. the blocking of the acquisition of Aixtron); or

> electronics (e.g. the termination of the sale of Philips' lighting unit Lumileds in the US).

All of these industries are intertwined with concerns about the wider social impact of such deals if the relevant national infrastructure is compromised. Indeed, national security has been cited as the main concern for regulatory resistance to some deals, including from across several countries at once. An example of this is the withdrawal of the German government's approval for the acquisition of Aixtron by Fujian Grand Chip in October 2016, and the US government's blocking of the acquisition of Aixtron's US subsidiary on the grounds that the Committee on Foreign Investment in the United States ("**CFIUS**") had concerns as to the deal being a potential risk to US security. Whilst Chinese firms investing outbound are not alone in facing scrutiny when investing in such industries, the prevalence of this issue for Chinese investors means it is one that cannot be ignored.

These issues are coupled with policy shifts from the Chinese government, which is now more actively regulating major outbound investment to address, amongst other things, perceived irrational investment outside areas of an acquirer's core business, and the level of debt supporting outbound M&A.

Despite potentially increased scrutiny by Chinese regulators and banks of some of the deals underlying these flows, we expect China to remain "open for business" with respect to genuine strategic overseas acquisitions and investments that fit with an acquirer's core business. If such investments are blocked in some jurisdictions, this may redirect Chinese players' interest towards other jurisdictions where similar strategically important investment opportunities are situated. It may also lead to more minority investments or joint ventures, potentially accompanied by contractual arrangements (e.g. licensing) to allow the Chinese acquirer to use the target company's technology to serve the Chinese market.

Chinese regulatory concerns at these acquisitions may also give opportunities for non-Chinese providers of capital to support Chinese overseas acquisitions, or for Chinese companies to use entities already acquired overseas to perform such deals.

Concern is rising over whether deals can get over the line under this increasing scrutiny. This short paper aims to provide background and assistance on the potential regulatory barriers for Chinese outbound M&A across key jurisdictions by providing high-level guidance and policy recommendations for succeeding in such deals, as well as country-specific information.

Key lessons and success factors

Lessons can be learned from recent experiences of regulatory concerns relating to Chinese outbound M&A. These lessons are informative for Chinese and other bidders and non-Chinese targets, as well as Chinese policymakers. In this report, we summarise the key trends from recent transactions and provide market participants and policymakers with suggestions on how to respond.

1

National security concerns are key and evolving

Host governments of many jurisdictions have been more readily and liberally applying far-reaching restrictions on foreign direct investment ("**FDI**"). This is not just a China-related issue as international investors from around the world are experiencing the impact of these restrictions. It is, however, a challenge that is more recently noticeably impacting Chinese buyers. This may be a result of the increase in the value of acquisitions made by Chinese buyers, as well as the increasing strategic importance which such acquisitions have to the economies of host jurisdictions.

These restrictions are especially applied to sectors associated with defence on the grounds of "national security" concerns - though not all deals that might be argued to have a "national security" angle have ultimately generated regulatory pushback on these grounds. For example, CFIUS cleared ChemChina's $43bn takeover of Syngenta, despite several US lawmakers requesting additional scrutiny for this deal from CFIUS due to food security concerns. By contrast, CFIUS-related factors have scuppered several smaller (albeit still very large in absolute terms) deals such as the acquisitions of or investments in Western Digital, Fairchild and Lumileds by Chinese companies – all of which are in the technology sector, which is much more associated with defence.

Recent anonymous reports in April 2017 suggested that the new US administration was concerned over the potential acquisition by Chinese investors of the nuclear businesses of Toshiba's bankrupt Westinghouse Electric Co. unit, with the US and Japanese governments discussing how to prevent "U.S. technology secrets and infrastructure falling into Chinese hands".[5]

US legislators and the Department of Treasury are proposing changes to allow CFIUS to increase scrutiny for acquisitions involving buyers from certain countries, including China. Although at the proposal stage, the legislation would create a tiered structure that would identify countries warranting increased scrutiny and increase CFIUS's scope to include transactions viewed as escaping its current purview, such as technology joint ventures, real estate transactions near military bases or other sensitive facilities.[6]

To take another example, in September 2016 the UK announced a review of the UK's foreign investment rules to assess whether the sale of "critical infrastructure" should fall within the government's scope of review – and while the review is not complete, this may well indicate increasing government scrutiny over sectors such as power transmission and distribution, electricity generation, telecoms, airports, rail, etc. Furthermore, after the Conservative party was re-elected in the UK's general election of June 2017, it was stated in the Queen's Speech that the government "will bring forward proposals to ensure that critical national infrastructure is protected to safeguard national security".

5 Source: Reuters, 7 April 2017

6 Source: Bloomberg, 15 June 2017

Most recently, as at the time of publication of this report (July 2017), the German government expanded its powers to block the takeover of German companies by non-EU acquirers. This new directive will allow Germany's Ministry of Economic Affairs and Energy to investigate deals endangering "public security and public order", involving a wide range of companies. The new legislation lists for the first time a catalogue of industry sectors where the acquisition by a foreigner is by law considered to be a potential threat to public security. This catalogue lists, for example, sectors such as information technology and telecommunications (e.g. cloud computing services). There is a special focus on the protection of companies that operate so-called "critical infrastructure" or develop software for such infrastructure. "Critical infrastructure" includes water and energy supply, health and nutrition, electronic payment facilities, and freight and passenger transport.

Once again, the implications of this will not be limited to Chinese firms, but their impact on Chinese buyers cannot be ignored.

In complex acquisitions, connections to sensitive industries in one country may stop deals outside of that country, and this is especially the case if there are grounds for national security concerns. For example, there has been press speculation that the re-opening of the German government's review of the acquisition of Aixtron may have been prompted by US security concerns given that Aixtron products are used in US weapon systems (e.g. Patriot missile defence systems). Acquirers faced with increases in regulators applying broad powers under national legislation to block, or withhold approval of, transactions need to thoroughly understand the breadth and depth of national security concerns in the particular jurisdiction (and in some cases, related jurisdictions) as they may apply to a given transaction. They should then develop comprehensive strategies, which may include undertakings to regulators, transactional remedies and effective PR strategies, to deal with these concerns.

Regulatory action relating to national security concerns can often be a "black box", with little guidance given as to how Chinese acquirers may remedy the perceived risks. For example, the opacity of the CFIUS review process has been one of the factors driving reverse termination fees being required from Chinese acquirers, though such fees may not be sufficient to overcome seller concerns. For example, in the failed acquisition of Fairchild Semiconductor, the reverse termination fee offered by the Chinese consortium was considered insufficient to compensate for the CFIUS risk.

2

More intensive scrutiny of FDI in regulated sectors

Acquisitions by Chinese and other foreign investors in specific regulated sectors (such as banking, insurance and other financial services, mass media, energy and telecommunications), which often require the approval of the industry regulator for the transaction to proceed, may also be derailed by concerns of the regulators with the perceived risks the acquisition poses to the target and to the sector's businesses, customers and wider stakeholders. Industry-specific concerns can be multiplied where the target has an established track record or is considered a significant or important market player in its home markets (indicated by measures including high market share), and where regulators are less familiar with the track record of Chinese businesses in overseas regulated markets. Examples include the failed acquisitions by Chinese buyers of Clal Insurance and Phoenix Insurance in the Israeli insurance sector as well as the failure of Anbang Insurance to successfully acquire the systemically important financial institution, Novo Banco of Portugal.

Dealing with the specific concerns of industry regulators in regulated sectors requires acquirers to be equipped with specialist product, sector and stakeholder knowledge, and/or a clearly defined and practically workable business plan that takes into account the target's position and standing in the market.

3

Foreign ownership of assets with significant potential impact to the interests of domestic nationals is of increasing concern to regulators

Even where national security concerns do not apply, the possibility of regulators and governments taking into consideration domestic public and media opinions in using their approval or review powers to block FDI transactions is increasing. It has been reported that the failure of bids by Chinese acquirers for Israel's Clal Insurance and Phoenix Insurance partially related to concerns in the Israeli news media with foreign control of domestic pension savings. Though Shanghai CRED and Hancock Beef (owned by Gina Rinehart, the richest woman in Australia) were successful in their recent bid for S Kidman & Co (Australia's largest private landholding), which enabled Kidman to remain majority Australian-owned, this success underlines the fact that in the past, a proposed sale of Kidman to a Chinese-owned entity had been blocked by Australia's Treasurer. The CRED/Hancock consortium gave the opportunity for continuing majority Australian ownership of the very large landholdings owned by Kidman.

Chinese acquirers need to evaluate and anticipate the host jurisdiction's receptiveness to Chinese investment in the sector of their potential acquisition. Partnerships with reputable local players can be extremely useful. In several jurisdictions, regulatory and governmental comfort with Chinese partner(s) in a bid consortium for a sensitive asset may depend on factors such as level of control, the levers of control available to the Chinese partner(s), and the level of access the Chinese partner(s) will have to the underlying operating asset (rather than at the "TopCo" or financing level).

4

Increased Chinese outbound M&A itself affects the perceptions of regulators towards Chinese acquirers undertaking new transactions

When reviewing a potential transaction, regulators of a host jurisdiction may take account of how comparable completed acquisitions have been conducted and managed by Chinese investors. In the mining and resources sectors, to take an example, the record of Chinese investors in several Latin American and African jurisdictions in labour relations and environmental compliance have been viewed negatively by the local press.

Accordingly, it will be important for Chinese acquirers to acquire a knowledge of the track record of other Chinese investors in previous comparable transactions in the relevant sectors and jurisdictions and evaluate, with their PR and marketing advisors, how to assure the local market that any mistakes of the past will not be repeated in the present transaction. It is important that Chinese investors do not appear to have exploitation of the local economy and resources as their sole motivation for their investments.

5

Timing is key

Regulators are becoming less predictable in their interpretation and application of FDI regulations, and success in a previous transaction that on its face appears comparable does not guarantee the success of a potential new acquisition. For example, the cleared acquisitions by State Grid of 19.9% of SP AusNet and 60% of Jemena, two of Australia's largest utilities, did not prevent State Grid's bid for 50.4% of Ausgrid from being rejected by the Australian government on national security grounds. In Europe, the clearance of the acquisition of Kuka by Midea now appears timely in light of the German government's re-opening of the acquisition of Aixtron in the same year, particularly given that both these deals involved exposure to the CFIUS regulatory process in the US.

At the start of the year we expected policy concerns to become even more relevant to transaction timetables due to several planned key elections. 2017 has already seen elections take place in the UK, the Netherlands and France. Additionally, the German election and the 19th Communist Party Congress in China are scheduled for later in the year.

The elections that have already taken place in 2017 have revealed political concern over FDI, including that expressed in the proposed and actual changes in legislation in the UK and Germany (as discussed in point 1 above). In point 13 below, we will discuss how Emmanuel Macron has called for the European Commission to explore ways to limit foreign takeovers in strategic sectors such as energy, banking and technology.

The importance of anticipating potential changes in an unpredictable global political climate should not be underestimated. It is increasingly important for deal timelines and milestones to take into account changing policy priorities. Working with partners that can give insight into how different national strategic concerns and policy priorities are evolving can help Chinese and other foreign acquirers succeed with their international programmes of outbound M&A.

6

Capitalising on Chinese acquirers' global reach can be beneficial

Some host jurisdictions (such as Spain) may be inclined to take a more favourable view of a proposed Chinese investment if the investing entity is located in another European jurisdiction. Conducting and funding the investment through a third party jurisdiction (as opposed to making the investment through an entity incorporated in China) is also likely to assist with the Chinese regulatory process.

Accordingly, success in some acquisitions may entail not just a knowledge of the law, practice and policy in the host jurisdiction. It also entails knowledge of the extent to which channelling the investment through third party jurisdictions may be perceived to be beneficial from a regulatory perspective, and evaluating the protection available to investors in such third party jurisdictions as well as the impact on tax and other structuring factors. Success may also require a multi-jurisdictional approach in presenting and packaging examples of successful acquisitions made by the acquirer (or its peers) in other jurisdictions to the regulators reviewing a particular transaction.

7

Governments and regulators are increasingly adopting a more stringent approach in scrutinising FDI applications

In some cases, this may result in the approval process being unexpectedly delayed or extended or a previous approval being revoked, such as the withdrawal of the clearance certificate by the German Federal Ministry of Economics for the acquisition of Aixtron from Fujian Grand Chip in October 2016.

To mitigate risks of an approved transaction being re-opened, early, open and thorough engagement is often highly beneficial when working with regulators and governments. It is essential to submit complete and correct documentation when applying for approval of a transaction. Ensuring that submissions are complete by their facts will minimise the chance of prolonged iteration with regulators, or even of cases being re-opened.

8

The Chinese regulatory approval process has contributed to a lower deal flow in 2017, and is an important consideration for the success of a Chinese outbound M&A transaction

The Chinese government continues to support outbound investment which has a genuine link to the firm's strategies, but is also seeking to regulate and filter out any substantial outbound investment which is not seen as in line with the acquirer's core business, and control what the regulators perceive to be "irrational" investments in certain sectors. Whilst there is merit in this policy objective, this new approach does create some potential added challenge for legitimate transactions which Chinese buyers will need to address.

Recent reports that the China Banking Regulatory Commission has asked Chinese banks to consider their level of exposure to some of China's most prolific acquirers of overseas assets may also signal a cooling of Chinese outbound M&A activity.[7]

These regulatory concerns will potentially increase the deal completion risk, and the expected duration to complete a deal, of Chinese acquirers in the minds of target companies and their shareholders.

Examples of recent situations where it is speculated that such Chinese regulatory concerns have been an issue include:

> Dalian Wanda's proposed acquisition of Dick Clark Productions (where the press has reported that "approval from regulators had been delayed but not denied"[8]);

> Anbang's bid for Starwood Hotels (where the press reported that "China Insurance Regulatory Commission could invoke a rule that restricts domestic insurance companies from investing more than 15% of their total assets abroad"[9] and that the deal "ended with China's regulators quietly blocking the transaction"[10]);

> Minsheng Bank's bid for Novo Banco, which was reported to have failed on the grounds of Minsheng being unable to secure the necessary funding as a result of China's foreign exchange control; and

> Chinese conglomerate LeEco's withdrawal of a $2bn deal for Vizio (a US electronics company), reportedly citing Chinese policy issues.[11]

In light of this change in policy and the list of high-profile deal cancellations, Chinese firms (particularly in a competitive bidding environment) will need to clearly demonstrate to sellers and targets that they can obtain the required Chinese regulatory approvals and remit the necessary funds to complete their acquisitions within the deal transaction timetable.

To deal with this added uncertainty, transaction structures and timetables, funds flow and financing arrangements designed with the new Chinese regulatory concerns in mind will be key. Parties should expect more attempts by sellers to pass Chinese regulatory approval risk to the Chinese buyers – for example, through the use of reverse termination fees. In some cases, it may even fall on the buyer to show it has access to ready funding outside China to enable its offer to proceed to completion.

7 Source: Bloomberg, 22 June 2017
8 Source: Financial Times, 21 February 2017
9 Source: Financial Times, 22 March 2017
10 Source: Financial Times, 29 December 2016
11 Source: Reuters, 11 April 2017

9

In complex transactions, the relationship among different jurisdictions and different deals is becoming increasingly important

For example, Aixtron faced a re-opening of the German government's review of its sale in October, and was informed that CFIUS would block the deal in the US in November.

Or, to take another example, the proposed investment in Western Digital by Unisplendour allowed either party to withdraw if CFIUS opened an investigation into the deal. This was a non-standard withdrawal condition, but such a condition may have been helpful in avoiding CFIUS-related risks from being incurred in the parallel bid by Western Digital for SanDisk.

Accordingly, the sequencing and inter-relation of complex international regulatory strategies has become ever more important, requiring deep and broad experience across the globe to tie together the regulatory concerns across all aspects of a complex multijurisdictional transaction (or, indeed, multiple transactions).

10

The efforts of politicians in host jurisdictions in seeking government intervention against transactions has become an increasing risk

Commentators have suggested that the acquisition of Germany's Kuka by Midea – reported to be opposed by German Vice-Chancellor Sigmar Gabriel – was assisted by political engagement, expressions of support from influential people and pledges regarding the maintenance of plants and jobs.

In addition, politicians in the US have often come out against Chinese outbound M&A. Examples include the food security concerns raised by ChemChina/Syngenta, Dalian Wanda/Legendary where 16 members of the US Congress wrote to the Government Accountability Office suggesting special scrutiny of this deal, and the proposed acquisition by Ant Financial (an affiliate of Alibaba) of money transfer company MoneyGram, where several US lawmakers have expressed concerns that "the Beijing-backed acquisition of MoneyGram could hurt America's financial infrastructure."[12]

In this last example, political concerns have been raised despite Jack Ma (Alibaba's founder) "promising to bring 1 million small US businesses on to Alibaba's platform in an effort to boost US exports to China" and "[pledging] to create 1 million US jobs, a move lauded by [US President] Trump."[13]

Furthermore, "Ant Financial has said that MoneyGram's data infrastructure will remain in the United States, with personal information encrypted or held in secure facilities on U.S. soil."[14]

Political concerns may arise even if the acquisition is not controversial on national security grounds (e.g. because of concerns relating to jobs being offshored).

As mentioned above, the elections that have taken place in the UK and France in 2017 have revealed increasing political concern over FDI. For example, in point 1 above, we discussed how following the UK elections, the re-elected Conservative government has proposed bringing forward proposals "to ensure that critical national infrastructure is protected to safeguard national security." In point 13 below, we will discuss how Emmanuel Macron has called for the European Commission to explore ways to limit foreign takeovers in strategic sectors such as energy, banking and technology.

Intelligent PR and public engagement with local stakeholders, followed by a comprehensive strategy to address local concerns, is a useful tool to help mitigate this risk.

12 Source: The Financial Times, 15 May 2017, https://www.ft.com/content/193bbffc-38af-11e7-821a-6027b8a20f23?mhq5j=e1

13 Ibid

14 Source: Reuters, 12 July 2017, https://www.reuters.com/article/us-usa-china-companies-idUSKBN1A532M

11

A wide variety of factors may be behind recent rejections by regulators of Chinese acquisitions

On one hand, in Germany, it could be argued that we have only seen one deal (Aixtron) fall foul of Act on Foreign Trade concerns. In the US, it could be argued that the increasing CFIUS scrutiny of Chinese deals is an inevitable consequence of the much greater deal volume and the increasing focus of this deal activity on sensitive sectors: recent CFIUS reports have noted that the US intelligence community believes "there may be an effort among foreign governments or companies to acquire US companies involved in research, development or production of critical technologies for which the United States is a leading producer."[15]

On the other hand, the governments of Germany, France and Italy have recently announced that they have written to Brussels asking for "more scope to investigate individual takeovers and, where applicable, block them"[16]: especially deals which are deemed to be "unfair... because they rely on state funds or are aimed at buying up important technologies."[17] And in the US, as mentioned in point 1 above, the Trump administration may well be considering increased scrutiny of Chinese acquisitions – notwithstanding that concerns about Chinese acquisitions of sensitive US businesses existed before the Trump administration.

With appropriate professional advice, the importance of distinguishing apparent concerns about Chinese investment from more general strategic and sector concerns in the host jurisdictions has now become key (both in terms of the approach to structuring a transaction, and dealing with the regulators approving it).

12

As the degree of co-ordination among regulators in FDI transactions increases, this may lead to some convergence of FDI regulations and regulatory approaches across jurisdictions

Several key EU countries are reassessing their approach to inbound FDI. For example, the UK's Department for International Trade is reviewing what the UK can learn from successful inward investment promotion agencies across the globe and will report on this in 2017 – press reports mention that regimes used in countries such as the US and Australia have been a focus of this investigation. If this is the case, experience of navigating deals in these jurisdictions may be highly relevant for future deals in the UK – in which case, using an adviser with an appropriately global reach becomes increasingly important.

13

Reciprocity is an increasing concern, especially in Europe

Germany's Chancellor Angela Merkel commented at the time of the Midea/Kuka deal on the lack of "reciprocity" between the EU and China in relation to the openness of their respective economies to FDI.

The theme of "reciprocity" has continued in Europe over the last year. In February 2017, Germany, France and Italy started pushing the EU to adopt rules to limit takeovers in sensitive industries by companies from non-EU countries, saying they want to create the legal basis for national governments to be able to "intervene in direct investments which are state controlled". Germany, France and Italy have also expressed concerns about a lack of "reciprocity" between the EU and other economies – clearly including China – on openness to FDI.

In a "Reflection Paper" published in May 2017, the European Commission noted concerns about "foreign investors, notably state-owned enterprises, taking over European companies with key technologies for strategic reasons", while "EU investors often do not enjoy the same rights to invest in the country from which the investment originates."

And at the recent EU summit in Brussels in June 2017, France's President Emmanuel Macron led a call to ask the European Commission to explore ways to limit foreign takeovers in strategic sectors such as energy, banking and technology. France said that this call was driven by a perceived lack of reciprocity in relation to the mutual openness of markets to foreign investment between China and Europe, as well as perceived risks to national security.

15 Source: Public Version of CFIUS Annual Report to Congress for CY 2014, February 2016

16 Source: Financial Times, 14 February 2017

17 Ibid

However, Emmanuel Macron and Germany's Angela Merkel ran into resistance from pro-trade Nordic, Benelux and Baltic countries aligned with Portugal, Greece, Ireland and Spain. While Mr Macron wanted an EU mechanism to vet and potentially block unwanted takeovers from non-European companies, especially from China, in the end, the EU summit agreed to a "watered-down version that simply analyses deals without any blocking mechanism".[18]

Finally, as noted in point 1 above, as at the time of publication of this report the German government had just expanded its powers to block the takeover of German companies by non-EU acquirers. While the directive certainly includes a significant national security motivation given its focus on "critical infrastructure", it should also be noted that Germany's Economics Minister, Brigitte Zypries, said that "the measures set out in the new directive should "ensure more reciprocity".[19]

From a policy perspective, further liberalisation of the Chinese economy to foreign inbound investment will help assuage these concerns, on top of the intrinsic benefits that can arise from such liberalisation. Having advisers equipped to explain this liberalisation to the regulators scrutinising a transaction within the context of the host jurisdiction's national priorities may become increasingly important to the deal.

18 Source: Financial Times, 23 June 2017

19 Source: Financial Times, 12 July 2017

Policy implications

Chinese policymakers can capitalise on these trends to help Chinese acquirers succeed in outbound M&A transactions in the current environment.

There is ripe ground for policy initiatives from the Chinese government to support the success of Chinese outbound M&A. Government policy recommendations arising from the trends highlighted above include:

> Open engagement is an area where the Chinese government can continue to play a useful role. Its measures on reforming information disclosure and transparency will help regulators and governments in other countries understand and overcome concerns about Chinese acquirers, especially in relation to questions about ownership, governance structures, relationships to the state, etc.

> The Chinese government, as well as global advisory firms, can play a helpful role by convening networks and forums to help establish and deepen links between Chinese companies and reputable local players, and between Chinese domestic and international regulators. China's diplomatic engagement via its extensive network of embassies helps Chinese businesses build relationships and networks in local markets (for example, the support that the Chinese government has given to the establishment of the Chinese Chamber of Commerce in the UK) and in turn gives them the connections and knowledge needed to understand and navigate the local market and regulatory framework.

> Initiatives by the Chinese government to make the regulatory framework in China more transparent will be very helpful in making overseas targets become more comfortable with Chinese regulatory risks relating to outbound M&A, and thereby help improve the attractiveness of Chinese bids.

> Accession by the Chinese government to international business treaties and agreements, coupled with efforts to encourage and require Chinese businesses to comply with international standards and rules, will improve the perception of Chinese investors overseas and make host jurisdictions more receptive to Chinese investment.

> Business education programmes targeted at executives and senior management will be useful in helping them understand and anticipate the challenges and opportunities they will need to navigate in order to successfully invest overseas.

Appendix

Australia

Australia has a foreign investment approval regime that regulates certain types of acquisitions by "foreign persons" of equity securities in Australian companies and trusts, and of Australian businesses and Australian real property assets. Whether a proposed transaction requires approval (commonly known as FIRB (Foreign Investment Review Board) approval) depends on various factors including the nature of the acquirer and the target, and whether the relevant approval threshold has been exceeded. FIRB approvals can be granted unconditionally or subject to conditions.

In respect of business acquisitions, privately-owned Chinese investors are generally subject to a A$1,094m threshold (which, due to the China-Australia free trade agreement, is higher than the standard A$252m threshold). The threshold is based on the value of the proposed target. However, many Chinese investments in Australia are undertaken by state-owned enterprises, which are subject to a A$0 threshold (though they can generally acquire up to 10% of an Australian target without approval).

Proposed investments, particularly by state-owned enterprises, in critical infrastructure assets (such as electricity, water and ports sectors) attract more regulatory scrutiny than others. The Australian government is focused on comprehensive assessments of the national security risks associated with proposed foreign ownership of critical infrastructure. National security issues were cited by the Australian government as the reason for rejecting State Grid's bid to acquire a 99 year lease of 50.4% of Ausgrid, the electricity distribution network in the State of New South Wales.

In January 2017, the Australian government launched a Critical Infrastructure Centre, within the federal Attorney-General's department, to "develop co-ordinated, whole-of-government national security risk assessments and advice to support government decision-making on investment transactions." This will include decision-making on FIRB applications. **Early and open engagement** with the Foreign Investment Review Board will assist in facilitating a smooth assessment process.

Belgium

There are no specific regulatory blocks to a Chinese acquisition in Belgium. Belgium possesses an open economy favouring international investments, and no regulatory restrictions against foreign investors have been set up.

Some sectors, such as banking, insurance, energy, pharmaceuticals, broadcasting and food production, are subject to ongoing regulatory supervision. It should also be noted that the Belgian regulatory framework is divided at federal level, and between regions and communities. Regional or community wide legislation may therefore require permits to carry out certain activities such as opening department stores, providing transportation and security services, selling firearms and ammunition or cutting diamonds, but the legislation has no discriminatory effect on foreign investments. Although the Belgian regulatory framework is quite stable and transparent, **partnering with major local entities will be helpful** in the process to obtain all the relevant authorisations.

France

There are no regulatory barriers specifically targeting Chinese investments and acquisitions in France. Indeed, foreign investments are generally permitted in France. However, in order to preserve French national interest, foreign investments in some sensitive sectors require the prior approval of the Minister of Economy ("**MoE**"), in particular activities that are essential to ensure national interests related to civil order, public safety and national defence, which include security, weapons and ammunition, etc.

On 14 May 2014, the government issued the Montebourg Decree which significantly extended the scope of transactions subject to prior approval which now includes investments in, *inter alia*, the following sectors: gas and electricity, water supply, transportation, electronic communications and public health. As a consequence, it is not now always easy to assess whether a transaction falls within the scope of the foreign investments regulation.

Given the consequences of not complying with the foreign investments regulation (nullity of the transaction and fine up to twice the amount of the investment), foreign investment approval is usually included as a condition precedent to completion.

It should be noted that there is a specific procedure which allows foreign investors to ask the MoE to confirm whether or not the contemplated transaction falls within the scope of the foreign investment regulation.

One practical tip would be to proceed to 2 in 1 notification, i.e. when requesting whether or not the contemplated transaction falls within the scope of the foreign investments regulation, requesting in the meantime that should it be the case, such notification shall be deemed a formal request for authorisation – this would allow limiting the maximum time period to obtain the MoE consent to two months rather than four.

It should also be noted that France, together with Germany and Italy, has written to the EU to adopt rules to limit takeovers in sensitive industries by companies from non-EU countries, saying it wants to create the legal basis for national governments to be able to "*intervene in direct investments which are state-controlled*".

At the EU summit in June 2017, several EU member states, including Spain, Greece and Portugal, opposed a proposal put forward by France's Emmanuel Macron and supported by Germany's Angela Merkel calling for a stronger control of Chinese investments in strategic European industries.

In the face of this opposition, the EU summit "agreed to a watered-down version that simply analyses deals without any blocking mechanism."[20]

20 Source: Financial Times, 23 June 2017

Germany

Generally, there are no restrictions on the takeover of private companies in Germany apart from merger control regulations. However, the Act on Foreign Trade (*Außenwirtschaftsverordnung* or "**AWV**") entitles the Federal Ministry of Economics to forbid or restrict the direct or indirect acquisition of a stake in a company by a foreign investor if public safety or public order is threatened and if 25% or more of the voting rights are acquired.

Due to growing concerns in Germany that Chinese acquisitions might affect Germany's industrial sector and the security of industrial and corporate data, sectors with know-how relevant for the production of high end technology products attract more regulatory scrutiny than others. Except for some rare exceptions, however – e.g. in the defence sector – German law does not categorically prohibit the relocation of assets, sub-divisions, business activities or know-how from Germany to foreign countries.

In relation to the parliamentary elections in 2017, it may well be that the German approach on investments in Germany will change into a more protectionist one, especially as long as German investments in China are more restricted. Germany, together with France and Italy, is currently pushing for the EU to adopt rules to limit takeovers in sensitive industries by companies from non-EU countries, saying it wants to create the legal basis for national governments to be able to "*intervene in direct investments which are state-controlled*".

While being supported by some members of the European Parliament, the Vice-President of the European Commission, Jyrki Katainen, stated that the EU intends to stay open to foreign investment.

Furthermore, at the EU summit in June 2017, several EU member states, including Spain, Greece and Portugal, opposed a proposal put forward by Emmanuel Macron and supported by Angela Merkel calling for a stronger control of Chinese investments in strategic European industries.

In the face of this opposition, the EU summit "agreed to a watered-down version that simply analyses deals without any blocking mechanism."[21]

Most recently, as at the time of publication of this report (July 2017), the German government expanded its powers to block the takeover of German companies by non-EU acquirers by amending the AWV. The new legislation will allow Germany's Ministry of Economic Affairs and Energy ("**BMWi**") to investigate deals endangering "public security and public order", involving a wide range of companies. The new legislation lists for the first time a catalogue of industry sectors where the acquisition by a foreigner is by law considered to be a potential threat to public security. The catalogue lists, for example, sectors such as information technology and telecommunications (e.g. cloud computing services). There is a special focus on the protection of companies that operate so-called "critical infrastructure" or develop software for such infrastructure. "Critical infrastructure" includes water and energy supply, health and nutrition, electronic payment facilities, and freight and passenger transport.

It should be noted that the list of sensitive industry sectors given above is not exhaustive: so any other transaction may potentially fall under the scope of foreign investment control if the BMWi deems it a danger to the public order and security of Germany.

Further, the amended regime also applies to takeovers of German target companies by entities located in the EU if there are indications that such approach was chosen only to bypass the assessment described above. This might also include so called "indirect acquisitions" where non-EU acquirers establish European vehicles to purchase German companies.

In addition, certain time limits and deadlines are being extended regarding the review of such investments. Consequently, the BMWi will have more time to examine a case and to consider whether it should take measures.

For example, under the old regime of cross-sectoral review, if a company was to be acquired, the BMWi could only deal with an acquisition if it initiated a formal examination within three months of the signing of the SPA. Now, the expiry period for such *ex officio* examination still amounts to three months, but it only starts after the BMWi gains positive knowledge of the acquisition. If the acquirer cannot prove that the Ministry gained knowledge of the transaction, the BMWi may, under the new rules, retroactively start an examination for up to five years after the transaction's signing.

Also, the periods within which the BMWi may take measures after initiating a formal investigation into an acquisition have also been extended.

21 Source: Financial Times, 23 June 2017

Precautionary measures should be taken, in particular in view of investments in companies that are active in the newly-listed industry sectors, such as energy and transport. Such investments now have to be expressly notified to the BMWi, and it is to be expected that they will be examined more thoroughly and intensely by the Ministry. Investors should thus be prepared to accommodate for these longer periods in their acquisition time-frames.

For investors, these new rules lead to considerable uncertainty regarding the time-frame for a successful closing of the transaction. Foreign investors should therefore be prepared to accommodate longer periods for foreign investment control. Moreover, the potential uncertainty will also, in our view, increase the relevance of clearance certificates as a risk mitigation option.

With the so-called “clearance certificates” (*“Unbedenklichkeitsbescheinigung”*), the AWV already provides a tool for a foreign investor to obtain legal certainty regarding an envisaged transaction. Investors can (informally) apply for such a certificate by notifying the BMWi about the planned transaction.

With regard to this instrument, the amendment of the AWV now gives the BMWi two months (rather than one month) to decide whether it launches a formal investigation procedure, or whether it issues the requested certificate. If the BMWi does not react within two months, it is deemed that the Ministry does not object to the acquisition.

Clearance certificates are an established route if it cannot be ruled out that the acquisition may be considered a threat to public security (i.e. in most transactions where the target operates in sensitive areas). Obtaining clearance from the BMWi is thus a closing condition in many SPAs, where a foreign investor intends to acquire a Germany-based company.

Despite this change in legislation, it should be borne in mind that so far the Aixtron case remains the only exception in the history of the AWV.

It is essential to submit complete and correct documentation when applying for approval of a transaction. Ensuring that submissions are complete by their facts will minimise the chance of prolonged iteration with regulators, or even of cases being re-opened.

India

India operates exchange controls which regulate foreign investment/M&A into India. However, these apply to all non-residents equally (other than those from Pakistan, Nepal, Sri Lanka and Bangladesh). 100% foreign investment is permitted in most sectors without any prior approval, but foreign investment in some sectors is subject to prior government approval (from the Foreign Investment Promotion Board) – for example, multi-brand retail, pharmaceuticals (but only to acquire existing companies), in the print media and in broadcasting companies.

In addition, companies require specific licenses to operate in certain specific sectors and the grant of a license can be conditional upon the security credentials/perceived security threat of the applicant company and/or its owners (for example, defence, telecommunications (to operate mobile networks or own infrastructure) and airports/aviation). This issue can be informed by, among others, wider national security considerations, which may constrain Chinese involvement in these sectors.

Finally, it should be noted that the Indian regulatory framework is divided at federal and state level, and legislation may therefore require permits to carry out activities such as manufacturing particular items but these rules do not discriminate between India- and foreign-owned entities.

The government of India recently abolished the Foreign Investment Promotion Board (which was responsible for approving foreign investments). This role will now be performed by the relevant government ministries/departments. The process for obtaining approvals, the allocation of industry sectors to ministries (where the identity of the responsible ministry is not apparent) and the interaction between ministries where there is overlap has not yet been finalised.

Indonesia

Under Indonesia's foreign investment regime, foreign investments into certain sectors are subject to restrictions. As foreign investment restrictions, which are set out in the Negative Investment List, apply equally to all foreign investors, there are no specific regulatory blocks to a Chinese acquisition in Indonesia.

Investments into certain sectors are more closely supervised and regulated by their sectoral regulators, including the financial services sector, which is regulated by the Indonesian Financial Services Authority ("**OJK**"). In recent foreign investments into the banking sector, the OJK has required, as a condition to granting its approval for the investments, foreign investors to secure reciprocal favourable treatment for Indonesian investments into the banking sector in their home countries. This has led to a number of memoranda of understanding between the OJK and foreign banking regulators, including the China Banking Regulatory Commission, in connection with such reciprocity.

Indonesia updates its Negative Investment List at intervals of two to three years, but we are not aware of any contemplated political or regulatory changes that would materially alter the overall foreign investment regime.

Employing the right engagement strategy with the regulator at an early stage is crucial to achieving successful completion of transactions in Indonesia. There is also an increasing scrutiny by manpower authorities on foreign-owned Indonesian companies' use of foreign labourers to perform roles that can be undertaken by domestic workers, and foreign (including Chinese) investors should be mindful of potential pitfalls in this area.

Italy

The "Golden Powers" Law gives special powers to the Italian government (so-called "golden powers") with respect to companies that carry out national strategic activities and/or own assets in the sectors of defence and national security, energy, transport and communications. In particular, these special powers can range from specific conditions imposed to a veto on the proposed transaction.

The Golden Powers Law as well as the implementing regulations provide that the Italian government shall abide by objective and non-discriminatory criteria in exercising its golden powers.

Unfortunately, the decisions of the Italian government with respect to the exercise of the golden powers are not public. So far, we are not aware of transactions which have triggered the veto right of the Italian government. However, it seems that in some cases the Italian government has imposed some conditions. For example, with respect to the creation of a 50/50 joint venture (H3G) between CK Hutchison Holdings (a listed Hong Kong-based conglomerate) and VimpelCom Ltd to combine their Italy-based telecommunication businesses, the Italian government recommended maintaining in Italy activities that could compromise national security and the continuity of the services.

Italy, together with France and Germany, has written to the EU to adopt rules to limit takeovers in sensitive industries by companies from non-EU countries, saying it wants to create the legal basis for national governments to be able to "*intervene in direct investments which are state-controlled*".

It is our understanding that many transactions are notified to the Italian government even in cases in which the golden powers may well not be applicable (to be on the safe side and avoid the application of the sanctions provided by the golden powers regulations), so it could, where appropriate, be advisable to take the same approach in doubtful cases.

Japan

There are no specific regulatory blocks to a Chinese acquisition in Japan.

Foreign investment is generally permitted in Japan, and is subject to limited restrictions in sensitive business areas viewed as necessary to protect national security and preserve national interests. Foreign investments are regulated primarily by the Foreign Exchange and Foreign Trade Act, which stipulates that foreign investments in particular sectors (e.g. agriculture, forestry, fisheries, petroleum mining and refining, telecommunication services, broadcasting, utilities, transportation and manufacture of equipment/products related to petroleum, leather goods, aircraft, weaponry, atomic energy and space development) require prior approval from the relevant Japanese government ministers.

Each relevant ministry shall review a planned foreign investment and approve or deny the foreign investment based on the review. In some sectors, foreign ownership is regulated by other laws such as the Broadcast Act and Civil Aeronautics Act. In addition, some general regulatory requirements apply to investments made by any person or entity, including both domestic and foreign investors. For example, acquisition of 20% or more of a bank or insurance company requires prior approval from the Financial Services Agency.

Luxembourg

There are no general restrictions on foreign ownership of businesses or shares in Luxembourg, nor does Luxembourg have specific legislation concerning merger control. As a general rule, there is no particular restriction on overseas investment in Luxembourg.

Specific rules exist for regulated markets such as banking or other financial activities, but the legislation has no discriminatory effects on foreign investments.

Middle East

As a general rule, in most Gulf Cooperation Council countries (the "**GCC**") in the Middle East, the shares of companies investing in "onshore" GCC assets will need to be at least 51% owned by local shareholders. Ownership restrictions may be greater in certain circumstances and sectors, for example restrictions existing in the energy sector, the insurance sector, the real estate sector and the operation of commercial agencies and banks/financial institutions.

Certain jurisdictions allow greater foreign ownership of "on-shore" assets and the UAE, for example, has a large number of freezones where 100% foreign ownership is permitted for freezone (i.e. offshore) activities. Our Linklaters offices are located in two financial free zones – the Dubai International Financial Centre ("**DIFC**") and the Abu Dhabi Global Market ("**ADGM**"). The ADGM in particular has introduced some commercially attractive corporate structures for foreign investment including a special purpose vehicle which permits businesses to set up a company in the ADGM as a pure holding vehicle for assets without the need to establish a presence in the ADGM by leasing premises or hiring employees.

Furthermore, in a number of GCC jurisdictions it is very common for a local shareholder to hold shares pursuant to a contractual nominee arrangement on behalf of an international investor.

As oil revenues have diminished, Middle Eastern governments and businesses continue to give careful thought to future sources of revenue and funding. VAT will be introduced in the GCC shortly and a number of Middle Eastern countries and government related entities have sold international assets, mostly stocks and bonds but also illiquid assets, or sought access to the public and private debt markets to borrow money. Such disposals have created investment opportunities for foreign investors. Governments are also keen to attract foreign investment in their countries to contribute financial resources and intellectual capital, and are therefore encouraging legal and market reforms to create a favourable and attractive environment for them. We are already seeing such reforms in many countries (e.g. relaxation of certain foreign ownership restrictions) in the region.

To undertake business in the Middle East, it is highly likely that a Chinese investor will need to have a local partner. It is therefore important, as with all joint ventures, that the Chinese investor has a good and strong relationship with its local partner. Furthermore, if it is utilising a nominee structure, it is also important to work with a reputable nominee. Exiting GCC joint ventures can be difficult as specific performance is not a remedy commonly available, and as such documentation should be carefully prepared.

The Netherlands

Any party intending to acquire a direct or indirect qualifying holding (i.e. more than 10% of the issued capital or voting rights) in a clearing institution, bank, UCITS manager, investment firm, entity for risk acceptance, premium pension institution or insurer which has its registered office in the Netherlands must obtain a declaration of no objection from the Dutch Central Bank or the European Central Bank in the case of a bank (this requirement stems from a European Directive so there are similar requirements in other European jurisdictions). Although the Dutch Central Bank can exercise discretion in issuing such declaration, the grounds on which an application can be rejected are exhaustive. The assessment criteria are:

> the integrity of the prospective acquirer or of the persons who, by virtue of the prospective qualifying holding, will or will be able to determine or co-determine the policy of the financial undertaking;

> the suitability of the persons who, by virtue of the prospective qualifying holding, will determine the day-to-day policy of the financial undertaking;

> the financial soundness of the prospective acquirer, relative to the financial undertaking's business activities;

> whether the financial undertaking will be able, as a result of the qualifying holding, to continue satisfying the prudential rules set pursuant to the Dutch Financial Supervision Act. Relevant considerations include whether the qualifying holding is structured such that supervision, information exchange and distribution of responsibilities between supervisory authorities are effective;

> whether there are good grounds for assuming that money laundering or terrorist financing play a role in the prospective acquisition or increase the risk of such activities being involved; and

> the completeness and correctness of the information provided by the applicant.

In our experience, the transparency requirement regarding the shareholding structure of the acquirer provides for one of the main trigger points for a regulatory block.

In addition to the specific declaration of no objection mentioned above which only applies to certain financial undertakings, deals can be blocked on the grounds of competition. We are not aware of any particular sectors which attract more regulatory scrutiny than others. However, there are specific rules in place, for example, with regard to companies in the utilities sector.

Poland

There are no specific restrictions regarding Chinese investment in Poland, though Chinese investors need to consider general restrictions applying to any non-EU investors, including: (a) restrictions applying to specific sectors (aviation or media); (b) requirements for obtaining consents for acquisitions in the financial sector (banking, insurance, and fund investment); and (c) the Polish State's consent requirements in respect of acquisitions of so-called strategically crucial companies, for example in the oil and gas and energy sectors.

The financial sector has traditionally been a sector of particular scrutiny. Investors would have to take into account the position of the Polish financial regulator, the KNF, which has traditionally been cautious in its approach to takeovers of Polish financial institutions by private equity and non-EU investors.

Unlike in other, more mature EU jurisdictions, there does not seem to be any particular resistance to Chinese investment in some sectors which are perceived as sensitive, such as pharmaceuticals, industrials, technology or IT, and there are examples of Chinese investment in most of these sectors.

Although after the 2015 elections the Polish government has in general become much more protectionist, it has consistently stated its interest in attracting Chinese investment and "reviving the Silk Road". This renewed government interest may have helped to mitigate against the publicity connected to the abandonment of construction of the A2 highway, which was planned to run from Warsaw to the German border, by China's COVEC in 2011.

In Linklaters' experience, there are ways to structure financial institution transactions based on EU passporting rules – including **using an existing subsidiary in another EU jurisdiction to acquire a Polish target.** Of course, each transaction needs to be assessed on a case-by-case basis and relationships with financial regulators also assist in clarifying any points in advance of filing notifications.

Portugal

In Portugal, there are no restrictions on foreign investment which specifically target Chinese investment or acquisitions. That said, the main infrastructures and assets allocated to national defence and security or to the provision of essential services in the energy, transportation and communication sectors are considered to be “strategic assets” and their holding is subject to Governmental authorisations.

Considering that there are no limitations to Chinese investment, we would recommend attention is paid to the specificities of the Portuguese legislation and political and business environment.

Russia

As foreign investment into the Russian economy has generally slowed down since the beginning of the Ukraine crisis, the Russian authorities have been promoting co-operation with Russia's eastern partners as part of the "pivot East" strategy adopted by the Russian government. Historically, oil and gas and other natural resources have been a prime area of interest for Chinese investors in Russia. Additionally, other industries, such as transportation (sea ports and terminals, in particular), technology (including tech parks) and the finance industry are growing in terms of interest and incoming Chinese investment, and are expected to continue to grow.

Certain industries which are regarded as strategically significant for the Russian economy and security are still subject to specific restrictions for foreign investors and, as a separate category subject to stricter controls, foreign state-controlled investors. The restrictions primarily relate to limitations of participation in the share capital or acquisition of assets in these "strategic" industries. Foreign investments into the following industries will entail significant scrutiny from the regulators and in some cases may be subject to a regulatory block:

> military, air & space, nuclear & radioactive, mass media, natural resources, oil & gas and energy, agriculture and agricultural land, pharmaceuticals, ports and airports;

> less sensitive areas which are also subject to scrutiny include the financial & insurance industry; and

> industries which are likely to be highly protected from foreign (including Chinese) investments include fishing and, by some reports, precious stones & metals.

Singapore

There are no general restrictions on Chinese or other foreign ownership of businesses in Singapore. However, certain sectors are regulated in Singapore insofar as there are statutes which limit or require prior regulatory approval for share ownership in companies engaged in those sectors. These approvals are required regardless of the nationality of the investor. The sectors which are subject to such controls are those generally perceived to be critical to national interests, such as banking, finance, insurance, media and telecommunications. There are also some sectors, such as the newspaper sector, which prescribe that only Singaporeans can be directors.

Spain

The biggest hurdle for a Chinese company to invest in Spain is that in certain economic sectors there are restrictions or controls on investors that are from outside the European Economic Area.

However, most economic sectors in Spain are completely liberalised, so there would be no restrictions or obstacles to stop a Chinese or any other foreign investor from acquiring Spanish companies that operate in those sectors. For example, a sector of interest to Chinese investors, given its relationship with raw materials, would be the mining industry, in which there are no restrictions. There are also no hurdles for Chinese investors to invest in Spanish football clubs, as they have done in other European countries.

The energy, audiovisual and defence sectors are among those subject to the most significant controls or restrictions on investment by a Chinese investor. The main restrictions or controls in these industries are:

> Defence: any investment by a Chinese investor in the defence sector would always have to be authorised by the Spanish cabinet, the Council of Ministers.

> Energy: any stake acquired by a Chinese investor that gives it significant influence over companies engaged in regulated activities (e.g. power transmission and distribution) or that manage assets that could be considered critical (nuclear plants, for example) must be notified to the Spanish competition authority (the "**CNMC**"), which may impose conditions if it considers that the investment could endanger the regulated activity or management of a critical asset.

> Audiovisual: acquisitions of stakes by Chinese investors are subject to the principle of reciprocity, so a Chinese investor will be treated the same as a Spanish investor in the audiovisual sector in China. The investor also cannot take a stake of more than 25% of the share capital of a Spanish audiovisual company.

The same principle of reciprocity applies to any award of contracts by Spanish public authorities.

In our experience, **regulators often take a more favourable view of those investors that use Spanish or European vehicles to invest, with which it is possible to check that the investor is active in other European countries.** This is to show that its investment activity in Europe is stable, particularly in sectors where there are restrictions or controls over investments.

Thailand

Generally, foreign ownership restrictions in Thailand apply to all non-Thai investors. Certain exemptions are available to the nationals of other countries which have entered into a treaty with Thailand that provides for such exemptions. There are no special restrictions on or exemptions from the general foreign ownership restrictions for Chinese investors, and this is not expected to change in the near future.

Thailand has both general foreign ownership restrictions and industry-specific foreign ownership restrictions.

The main legislation governing foreigners' participation in businesses in Thailand is the Foreign Business Act B.E. 2542 (1999) (the "**FBA**").

The term "foreigners" is defined under the FBA as:

(i) foreign nationals;

(ii) foreign entities;

(iii) Thai entities of which at least 50% of the share capital is held by (i) or (ii); or

(iv) Thai entities of which at least 50% of the share capital is held by persons in (i), (ii) or (iii).

The FBA will apply if a non-Thai shareholder has a shareholding of 50% or more of the total issued shares of a company incorporated in Thailand.

The FBA sets out a number of restricted businesses which foreigners are prohibited to engage in. These restricted businesses are divided into three annexes:

(i) Annex One sets out businesses which foreigners are absolutely prohibited to engage in (e.g. newspaper business, radio broadcasting or television);

(ii) Annex Two sets out businesses affecting national security or arts, culture, tradition, local handicrafts or natural resources and the environment, which can only be operated by foreigners provided that a licence is obtained with Cabinet approval (in practice, a licence for a restricted business under Annex Two has never been given to foreigners); and

(iii) Annex Three contains businesses which can only be operated by foreigners, provided that a licence from the Ministry of Commerce ("**MOC**") is obtained, which includes retail sale and wholesale businesses and all categories of service business (except services which are specifically exempted by regulations issued by the MOC), among others. The granting of a licence to a restricted business in Annex Three is determined at the MOC's discretion. In practice, the MOC does not grant a blanket licence for certain businesses and grants a licence only if the scope of business is limited. For example, the retail sale and/or wholesale of a product manufactured by a group company would be acceptable, but a licence would not be granted for the broad retail and/or wholesale of products of various unrelated third parties.

Certain exemptions from the FBA exist under treaties Thailand has entered into with the United States, Australia, Japan and members of the ASEAN Economic Community (AEC). Thailand does not have such a treaty with China, and therefore, these exemptions are not available to Chinese investors.

Another set of foreign ownership restrictions can be found in the Land Code. Under the Land Code, a non-Thai person cannot own land and a company incorporated in Thailand will be regarded as a non-Thai person (for the purposes of determining a right to own land) if more than 49% of its total issued shares are held by non-Thai persons or if more than half of its shareholders are non-Thai persons. Foreigners whose business has obtained investment promotion privileges by the Board of Investment may be permitted to own land used in its operations under certain restrictions.

In addition, certain industries have specific foreign ownership restrictions. For example, the foreign ownership limit for a financial institution is 25%, which can be increased to 49% with the approval of the Bank of Thailand, and beyond 49% with the approval of the Ministry of Finance. The foreign ownership limit for insurance companies is 25%, which can be increased to 49% with the approval of the Insurance Commission, and beyond 49% with the approval of the Ministry of Finance.

The Bank of Thailand and the Ministry of Finance welcome strong international players to the Thai market. Their key criteria in considering an application for any non-Thai investor to hold a significant stake in a financial institution or insurance company are based on the "fit and proper" test, strength of the balance sheet, transfer of know-how, long-term investment objectives and other value which the investor can bring to the relevant sector. Where an acquisition requires an approval or waiver from the Bank of Thailand or the Ministry of Finance, a high-level relationship meeting and consultation with the working-level officers are recommended before a Chinese investor proceeds with a transaction.

If an investment requires a Foreign Business Licence, the scope of the relevant business should be reviewed in light of the policy and practice of the Ministry of Finance at the time. More stringent policies and practices in the future could mean that it is more difficult to obtain a licence or there will be more conditions attached to it.

Turkey

Foreign investors in Turkey benefit from equal treatment and are subject to the same requirements as domestic investors. There are no restrictions on the repatriation of capital or dividends. In general, foreign entities may freely acquire and dispose of equity stakes without any limit on ownership or restriction other than merger control. There are a few exceptions such as the radio and television, aviation and maritime transport industries, where foreigners may not hold a majority interest.

The political climate in Turkey is generally favourable to Chinese investors. Renewed cooperation mechanisms have been established under the "Memorandum of Understanding on Aligning the Silk Road Economic Belt and the 21st Century Maritime Silk Road and the Middle Corridor Initiative" signed between China and Turkey on 14 November 2015. In addition, a new Bilateral Investment Treaty was executed on 29 July 2015 to replace the 1990 BIT for the reciprocal promotion and protection of investments between the two countries. China and Turkey also have a bilateral income tax treaty and a bilateral treaty for the reciprocal enforcement of foreign judgements.

Chinese FDI in Turkey was valued at $642.3m in 2016, and this is expected to increase significantly in the coming years. Recent major transactions testify to this trend, such as the Industrial and Commercial Bank of China ("**ICBC**")'s $316m acquisition of Turkish banking group Tekstilbank in May 2015, or Chinese smartphone giant ZTE's $101m acquisition of 48.04% in Turkish integration systems Netaş, announced in December 2016.

Chinese companies are in particular expected to invest in the infrastructure, transportation, energy and technology sectors. While some of these investments will require regulatory approval, they should be viewed favourably by Turkish authorities.

The key to a smooth regulatory process in Turkey is the management of communication with the relevant regulatory authorities throughout the transaction. Investors should analyse and determine from the outset the stages at which, and the manner in which, regulators should be approached, sometimes through courtesy visits at an early stage. While Turkey encourages foreign, and in particular Chinese investments, regulators will wish to have a complete understanding of the identity, structure and capacities of the investor when reviewing a regulatory application.

Analysis provided by Paksoy, Istanbul

Ukraine

Generally, Ukrainian law does not restrict foreign investors from investing into Ukraine. There are, however, a limited number of restrictions: namely, foreign companies are restricted from owning agricultural land and manufacturing carrier rockets. Ukrainian law authorises the government to set limits on foreign participation in “strategically important areas”, but this law is rarely used in practice.

There is no special (positive or negative) treatment of Chinese investors compared to other foreign investors and this is not expected to change in the near future.

Acquisition of businesses in regulated sectors such as financial services (including banks, lease and insurance companies), securities trading and renewable energy above certain thresholds must be approved by or notified to the respective regulator.

In addition, if the financial thresholds envisaged by Ukrainian competition law are met, a person (whether local or foreign) must obtain a prior approval of the Ukrainian competition authority in order to acquire a large stake in a Ukrainian company or to establish a joint venture.

We expect that further liberalisation of foreign exchange restrictions, as well as a recently adopted corporate law reform will have a positive impact on the M&A market during the next year.

Analysis provided by Avellum

United Kingdom

The UK maintains that it treats foreign-controlled companies the same way as UK-owned businesses. However, at the time of delaying the approval to CGN's investment in Hinkley Point, the government has hinted that it may review the UK's stance on foreign investment in "critical infrastructure" though the 2017 Green Paper on industrial strategy still stresses that the UK is open to investment. This has been followed up in the election manifesto of the re-elected government, which stated an intention to "ensure that foreign ownership of companies controlling important infrastructure does not undermine British security or essential services" and that there is strengthened ministerial scrutiny and control in some sectors, "such as telecoms, defence and energy".

Whilst government approval is not generally required for foreign investment, there are, however, a number of tools available to the government to monitor and influence foreign investment, in particular in regulated and "sensitive" sectors.

Within regulated sectors, and those sectors with government contracts, mechanisms exist for the government and agencies to manage issues through approval/consent processes, typically involving rigorous approval criteria. Chinese and Hong Kong based investors have successfully invested in regulated sectors in the UK.

The government also has power to prohibit acquisitions in sensitive areas which touch on public interests – broadly national security, plurality of the media or financial stability. To date these powers have been exercised very rarely, and we have seen investment from China across a broad range of sectors including infrastructure and finance.

Although in September 2016 the government announced a review of the UK's foreign investment rules to assess whether sale of "critical infrastructure" should fall within the government's scope of review, no further announcement has yet been made except in recent election campaign literature which proposed to update the rules governing mergers and takeovers to require bidders to be clear about their intentions at the outset of a bid, to make promises and undertakings made in takeover bids legally enforceable, and to allow the government to "pause" a bid for scrutiny.

Separately, the government announced that the Department for International Trade will review what the UK can learn from successful inward investment promotion agencies across the globe and will report on this in 2017. A key aim of the review is to consider whether there should be a greater emphasis on the effect of investment projects on growth and wealth creation for the UK.

The announcement of a review of the UK foreign investment rules potentially signals a change in the government's approach and a more interventionist approach.

One recurring theme from our experience is the **need for early dialogue and engagement with regulatory authorities as well as government agencies**, particularly in sensitive sectors. In addition, **partnering with established industry players has also proven to be helpful** in building up credibility and managing the process.

The UK regime is transparent and relatively stable making it attractive for Chinese investors. Detailed understanding of the local legislative frameworks and dialogue with the relevant regulators has allowed Chinese investors to successfully build up assets in a number of UK regulated industries such as electricity and transport.

United States of America

The US Committee on Foreign Investment in the United States ("**CFIUS**") is a regulatory body with authority to review transactions that may threaten the national security of the United States. "National security" has been broadly interpreted, and may be implicated by transactions in diverse industries. While a CFIUS filing is always voluntary, CFIUS has the authority to unwind transactions that have not been reviewed. In the case of state-owned enterprises (which are automatically subject to a full investigation by CFIUS), a key concern of CFIUS in past transactions has been whether the acquisition is being made on commercial terms with a transparent business rationale.

Certain outbound deals involving China had received increased scrutiny under the Obama administration, with a recent focus on transactions involving "critical technologies". It remains to be seen how the Trump administration will implement CFIUS, but we would expect the Trump administration to take a more restrictive approach.

In addition, federal law directly limits foreign ownership of companies in a limited number of sectors (e.g. aviation, telecommunications, utilities). Acquisitions exceeding certain size thresholds are subject to US antitrust regulations. However, antitrust clearance should be expected unless the transaction raises competition concerns.

To help understand CFIUS concerns, **key issues that should be addressed early in the diligence process should include:**

> whether the target's products are subject to US export controls;

> the CFIUS history of both the target and acquirer; and

> whether there are any government contracts or security clearances involving the target.

Our expertise

We have the world's pre-eminent China M&A practice. Our outbound M&A capability is augmented by our ability to call on leading practitioners across the Linklaters network in all areas of law relevant to M&A transactions. Our clients benefit from our combination of:

> Technical skills

> Market experience

> Cultural awareness

> Linguistic capabilities

> Commercial judgement

> International range

> Sectoral knowledge

Few other global firms can match our ability to successfully execute cross-border transactions requiring sector-specific understanding and knowledge of international market practices as well as local laws and regulations. This is why we are called upon by clients when strategic value is high, and sophisticated advice and a global footprint is required. This is reflected by our position as the **number one legal advisor** by value on Chinese outbound M&A globally over the last four years.[22]

The range of our experience is displayed by the fact that we have advised on matters relating to Chinese companies in over 70 jurisdictions during the past few years.

22 Source: Mergermarket database, by value of completed Chinese outbound M&A transactions globally, 1 Jan 13 – 31 Dec 16

Selected China outbound M&A experience

We have advised a wide range of clients on Chinese outbound M&A across the world. Examples include advising the following:

Asia Pacific

> ICBC on its public takeover of ACL Bank of Thailand

> Shandong Hengyuan Petrochemical on its acquisition of 51% interest in Shell Refining Company (Federation of Malaya) Berhad in Malaysia

> China Construction Bank on its acquisition of a 60% stake in PT Bank Windu Kentjana in Indonesia

> JD Capital on the US$1.4bn acquisition of the Hong Kong life insurance operations of Ageas

> Minmetals Resources on its C$1.3bn takeover of Anvil Mining (listed in Australia and Canada)

> (With our alliance firm Allens) State Grid on its acquisitions of 19.9% of AusNet and 60% of Jemena, two of Australia's largest utilities

> (With our alliance firm Allens) State Grid on its acquisition of 41% of ElectraNet in Australia

> (With our alliance firm Allens) Sichuan Tianqi Lithium Industries on its takeover of Talison Lithium (based in Australia and listed in Canada) for C$848m

> Noble Group on the US$1.5bn disposal of 51% of its agricultural business to a consortium comprising COFCO, HOPU and other international investors and on the formation of a joint venture to operate the business

Europe, the Middle East and Africa

> Acted as co-lead arranger on the US$20bn loan facility in relation to ChemChina's US$44bn acquisition of Syngenta – the largest China outbound M&A deal in history

> Pang Da Automobile on its takeover of Saab Automobile with Youngman Cars

> State Grid on its €387m acquisition of 25% of REN, Portugal's national state grid operator (the first time a Chinese company has acquired a stake in a European national grid company)

> Bright Food on its £1.2bn acquisition of a 60% stake in the Weetabix Food Company (and the subsequent US$1.76bn sale of the Weetabix group to Post Holdings)

> Wuhan Iron and Steel on its acquisition of a global tailored blank business from the German multi-industry conglomerate ThyssenKrupp AG, including operations in Germany, China, the US, Mexico, Turkey, Italy, and Sweden

> Power Construction Corporation on the acquisition of TLT Turbo, a ventilation systems manufacturer, from Siemens

> Hony Capital on its £900m acquisition of PizzaExpress

> NL Financial Investments and the Dutch State in relation to the acquisition and recapitalisation of Vivat, the Dutch insurer, by China's Anbang Insurance

> Fosun on its acquisition of a major stake in Banco Comercial Portugues, a Portuguese bank

> China Railway on its US$4bn investment in copper and cobalt mines in the Democratic Republic of Congo

> Rosneft on the sale of 20% ordinary shares in PJSC Verkhnechonskneftegaz, which holds a license to develop the Verkhnechonsk oil, gas and condensate field, to the Beijing Gas Group Co

The Americas

> SAIC Motor Corporation on its 1% stake acquisition in the General Motors IPO (the largest single IPO purchase in history at that time)

> Minmetals Resources on its C$1.3bn takeover of Anvil Mining (listed in Australia and Canada)

> ICBC on its US$700m acquisition of an 80% stake in Standard Bank Argentina

> (With our alliance firm Allens) Sichuan Tianqi Lithium Industries on its takeover of Talison Lithium (based in Australia and listed in Canada) for C$848m

> China Construction Bank on its acquisition of a 72% stake in Banco Industrial e Comercial, a Brazilian bank

> A consortium of investors including China Investment Corporation on a US$1.8bn investment in BTG Pactual, a Brazilian investment bank

> Jiuquan Iron & Steel on its US$299m acquisition of an aluminium mine and refinery in Jamaica

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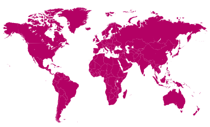

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** Office of integrated alliance partner Allens*
*** Office of formally associated firm Widyawan & Partners*
**** Office of collaborative alliance partner Webber Wentzel*
Δ Office of best friend firm TT&A

About us

Linklaters

About Linklaters

Linklaters is the firm of choice for the world's top business leaders. With 38 years' experience in the Greater China region, our team offers high quality legal services and works closely with both multi-nationals and PRC companies to help them achieve their cross-border and global strategic investment goals. In China, our integrated China team is made up of nearly 200 lawyers, half of whom speak Chinese, working across three major business centres: Beijing, Shanghai and Hong Kong. Each of our lawyers has his or her own specialisation in M&A and strategic investment both in and out of China, competition and regulatory, private equity, banking and projects, capital markets and dispute resolution. We are supported by our 29 global offices and best friends and alliance firms.

Allens > < Linklaters

About Allens

Linklaters' Australian alliance partner, Allens, has extensive experience in foreign investment applications, and has advised numerous private and foreign government investors. Allens is therefore well-placed to advise on the Foreign Investment Review Board regime, including on the types of transaction likely to attract more scrutiny than others and on the types of conditions that might be imposed on particular Foreign Investment Review Board approvals.

TT&A
Advocates and Solicitors

About TT&A

Linklaters has been active in the Indian market for over 25 years and has established an impressive track record, working with international companies and financial institutions as they invest or expand their activities in India. We have a best-friends relationship with Talwar Thakore & Associates (TT&A), a leading Indian law firm, and the two firms work closely to provide seamless advice to clients as a single team across the Indian and international elements of transactions. Working together, Linklaters and TT&A have been involved in high profile corporate transactions in India across both private and public M&A, and spanning a range of industry sectors. We are very familiar with the regulatory regime that applies to listed Indian companies in the form of the listing agreements and SEBI regulations and guidelines, and the Companies Act.

Widyawan & Partners

About Widyawan & Partners

Linklaters and Widyawan & Partners have a formal association in Indonesia and we work closely together to provide our clients with a market-leading international and Indonesian law capability. Our combined offering is recognised as one of the leading cross border practices with a capability that spreads across all sectors. Together we have acted on many of the first, largest and highest value projects in Indonesia.

Our fluency in both English and Bahasa enables us to actively participate in drafting, due diligence and negotiations with Indonesian counterparties and regulatory authorities and interpret the relevant laws and regulations.

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