Hot Topic

Global M&A: “Politics by other means” and the Weaponization of Global M&A
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Global M&A, including cross-border M&A, had a strong 2018. Hiding below the surface of the data, however, are a number of disturbing trends that do not bode well for continuing strength in cross-border M&A. Perhaps the most significant trend is what has been referred to by some commentators as the “weaponization of global M&A”—the use by national governments of the tools of regulation of M&A to advance, explicitly or implicitly, domestic political and trade agendas. Notwithstanding the strong performance of cross-border M&A in 2018, it still remains below its peak in 2007—back before the global financial crisis, before populist and nativist political tendencies rose in many developed economies and when faith in the social benefits of free markets and free trade was stronger. From the perspective of global M&A practitioners, we should hope that attitudes toward cross-border M&A revert to those prevailing in the mid-2000’s and hold back against overreaching regulatory trends.

2018 by the Numbers

Cross-border M&A in 2018 remained strong and accounted for approximately 30% of the global M&A market, measured by dollar volume of announced transactions. This represented a modest increase, in percentage terms, over 2017 and a high point in both dollar and percentage terms since 2007. Cross-border M&A followed the global trends and was heavily weighted toward the first half of 2018, as equity market volatility adversely affected M&A activity in the second half and particularly the fourth quarter of 2018.

However, 2018 did see the continuation of five trends with respect to cross-border M&A that should be noted. The first is that outbound M&A from China continued to decline from its peak in 2016 and was down approximately 23% in 2018 over 2017. This reflects both global regulatory headwinds (discussed below) as well as internal Chinese political factors. Second, outbound M&A from Japan resumed its general upward trend from a low in 2011-2012, increasing to $184 billion over $79 billion in 2017. The Japanese statistics were significantly skewed by one transaction (the Takeda acquisition of Shire). Even excluding that one transaction, however, outbound M&A from Japan increased almost 30% in dollar volume terms over 2017. Third is the continuing importance of the TMT and healthcare sectors in cross-border M&A, together representing almost 30% of deals by dollar volume, a very significant increase over the last 10 years. Fourth, most of the increase in overall cross-border M&A activity, as measured by dollar volume, was driven by the return of the “mega deal”, although cross-border M&A activity, measured by a number of transactions, also rose slightly. The increase in transaction numbers was, however, driven solely by private equity (including sovereign wealth fund) activity, and strategic cross-border M&A in 2018 was slightly down from 2017, measured by the number of transactions.

Regulatory Trends

A fifth trend that dominated cross-border M&A in 2018 was increasing regulatory headwinds.
It has become more difficult to clear growing global hurdles to cross-border M&A. There is no doubt that the length of time it takes to consummate a large cross-border M&A deal is increasing and the number of jurisdictions likely to scrutinize a complex cross-border transaction is increasing, while a noticeable number of high-profile cross-border M&A transactions in the last several years have been blocked.

I will begin with a note of cautious optimism. Intense scrutiny of cross-border M&A is not new, nor is the overlay of national economic self-interest in review of cross-border M&A a novel one. The rejection of the proposed acquisition of Woodside by Shell in Australia in 2001, the contested battle for Aventis in France in 2004, the failed potential acquisition of Danone in France in 2005 and even the fallout from the completed acquisition of Cadbury by Kraft in the United Kingdom in 2010 were historic examples of the difficulties created by regulatory review for significant cross-border M&A. On a more pessimistic note, however, there have been a number of negative developments in this area over the last several years.

**Expansion of Direct Regulation**

The first challenge is the expansion of direct regulation of foreign acquisitions and cross-border M&A. Cross-border M&A practitioners have long been generally familiar with the Canadian Investment Canada and Australian FIRB regimes—explicit “foreign investment” regimes with a clear “net benefit” or “national interest” standard. The last several years have seen increasing attention paid to the possibility of new, comparable regimes. The best example of this is the recent action by the European Union to establish an EU-wide framework for foreign direct investment (the “EU FDI Regulation”).

It certainly is possible that the EU FDI Regulation could have the effect of facilitating cross-border M&A by imposing EU discipline on member states, by requiring transparency and nondiscrimination and by enhancing cooperation between national authorities of member states. The EU FDI Regulation does not (yet) impose an EU-wide regulatory review process or agency or require the member states to create new regulatory systems. However, it is impossible to overlook the fact that the EU FDI Regulation arose out of pressure from the French and Italian Governments (along with the German Government) and that the French Government, in particular, has not been slow to advocate for national champions. It is also impossible to overlook that the EU FDI Regulation explicitly distinguishes between “security” and “public order” and specifically authorizes member states to regulate foreign direct investment to advance either objective. The EU FDI Regulation also refers to the “freedom and pluralism of the media”; in light of the concentration of the ownership of media (traditional, digital and social) in the hands of non-EU market participants and the vocal concerns about excessive informational power being held by foreigners, there can be little doubt this is an EU stamp of approval for the imposition of more nationalistic regulatory frameworks covering cross-border media mergers.

Taken as a whole, it seems much more likely that the EU FDI Regulation will not facilitate cross-border M&A and will instead throw additional sand in the works of cross-border transactions. This could come in the form of rejuvenation of preexisting member state regulatory review processes; for example, there is already speculation that Germany will
expand its previously moribund regime for foreign investment. The EU FDI Regulation also will likely encourage a number of member states that currently do not have foreign investment regimes to adopt them. Finally, particularly in the area of cross-border media mergers, there is a clear concern that the EU FDI Regulation will be taken by some member states as political cover for the imposition of media ownership rules that explicitly favor local ownership.

The EU FDI Regulation adopts the focus on concepts such as critical infrastructure and critical technologies, both of which have become important in the U.S. review under the Committee on Foreign Investment in the United States (“CFIUS”) and the Chinese review under the new State Authority for Market Regulation (“SAMR”) process. The EU FDI Regulation also contemplates that member states may focus on government-owned foreign investors, a feature which continues a global trend toward concern regarding foreign direct investment from state-owned enterprises and sovereign wealth funds.

One interesting side note is the potential interplay between the EU FDI Regulation and Brexit. For so long as the United Kingdom remained in the EU, it would not have been compatible with the common market for a member state to apply its foreign investment regime to an investor from the UK. With Brexit, however, that will become a possibility.

**Expansion of Existing Regulatory Frameworks**

A second trend is the expansion of preexisting regulatory frameworks. The best known recent example is the amendment to the United States CFIUS regime in August 2018 in the form of the Foreign Investment Risk Review Modernization Act (“FIRRMA”). In some respects, the analysis of FIRRMA has parallels to the EU FDI Regulation. One view of FIRRMA is that, by and large, it merely codified preexisting practices of CFIUS and, by creating a short-form declaration process, could facilitate cross-border M&A. In addition, by improving transparency, FIRRMA should improve the functioning and predictability of CFIUS.

However, skeptics abound. The background and legislative history of FIRRMA is more consistent with a negative view of cross-border M&A. FIRRMA clearly was motivated primarily by an increasing level of concern regarding foreign direct investment, particularly in the areas of critical infrastructure, critical technologies and emerging technologies, and only secondarily by a desire to improve the CFIUS process. Taken as a whole, it seems much more likely that these amendments will render cross-border M&A more difficult, particularly in the important area of technology, media and telecommunications.

The expansion of CFIUS through FIRRMA comes against recent history of the substantial tightening of CFIUS scrutiny, particularly of acquisitions by Chinese acquirors. While CFIUS itself has not yet published its official data for the most recent years, media reports about transactions suggest that the number of transactions blocked by CFIUS (or withdrawn in the face of CFIUS objections) exceeded 20 in each of 2017 and 2018, up from low- to mid-single digits in each of 2014 and 2015 (and low- to mid-single digits for 1988 through 2001 taken as a whole). Of those blocked/withdrawn transactions, over 80% were Chinese acquirors. It should be noted that the tightening of CFIUS review, particularly in the area of technology, is not purely a function of the Trump Administration. The increase in blocked/withdrawn
transactions, and the associated increase in the percentage of blocked/withdrawn transactions involving Chinese acquirors, clearly began under the Obama Administration no later than late 2015.

One of the criticisms of the CFIUS process has been its lack of transparency, which is heavily influenced by the lack of meaningful judicial review of CFIUS-related determinations. As noted above, one hope for FIRRMMA is that it will lead to greater transparency. The representatives of CFIUS, to the extent possible, emphasize that CFIUS determinations are grounded in defense and national security concerns (and not in trade policy). At this point, however, it has become almost impossible to separate the CFIUS review process from the deliberate application of a “naked” industrial policy in favor of American national technology champions. Given the strong market positions in the technology sector of many U.S. companies, a CFIUS-driven policy of limiting foreign influence in practice is now working the same way as would a policy of creating national champions, even if CFIUS diligently and in good faith limited itself solely with considerations of national security.

To paraphrase a question from another context: “So, Secretary Mnuchin, you say that you are not using CFIUS as a secret tool of the President’s trade and industrial policy. Tell me, if you were to do that, how would you behave differently?” A stony silence.

**Expansive Use of Other Regulatory Frameworks**

The third trend is the increasingly aggressive use of regulatory frameworks to scrutinize M&A from an industrial policy perspective, even if the framework itself is not intended to advance industrial policy. One recent example is the increasing use under the United Kingdom Takeover Code of “enforceable undertakings” by a bidder relating to a UK target of a takeover bid. This began with the completed acquisition by Kraft of Cadbury in 2010 and the view, after the fact, that Kraft had not been entirely truthful in its disclosures about its intentions toward the Cadbury business. Disclosure of a bidder’s plans with respect to a target company may be highly relevant to target shareholders (for example, if there is any possibility the bidder will not acquire 100% of the target), to some target shareholders in particular (for example, target employees who also are shareholders) and to shareholders of the bidder. The idea, however, that the nation should be able to extract binding undertakings as to the conduct of the target business post-acquisition as part of the regulation of a bid does not make logical sense. “Undertakings” are a well-understood component of actual foreign investment regimes, such as CFIUS, SAMR and FIRB, but do not belong in the capital markets rules about takeover bids.

In connection with the contest for control over GKN plc in the UK in early 2018 between Melrose plc and Dana Inc., the question of undertakings potentially played a key role. Although the winning bidder was the UK bidder and the not the foreign one, in light of concern that the UK bidder might break up a national champion the UK bidder was forced to agree to very restrictive binding undertakings. One can legitimately wonder whether the target shareholders actually cared so much about these undertakings or why it was appropriate that a contest over which transaction offered better value to GKN shareholders could possibly have been determined—as a matter of the UK Takeover Code—by the strength of commitments to maintain an English national champion in this industry.
A broader problem is the extent to which conventional antitrust merger clearance processes are being distorted by concerns of national industrial policy. Major merger clearance regulators around the world—in the U.S., the EU and Australia, for example—all claim their review of the antitrust merits of a combination is not affected by questions of national industrial policy. In the EU, for example, the recent proposed combination of the rail businesses of Siemens and Alstom was blocked on competition grounds, notwithstanding both the claim the combination was necessary to fend off a threat from a Chinese SOE and loud protestations by the French and German Governments. However, concerns linger. There are suggestions in the EU, following Siemens/Alstom, that horizontal merger principles should be adjusted when national interests are at stake. In South Korea, it is widely feared that the merger clearance process is unduly influenced by the question of whether the South Korean national champions in the technology and shipping sectors may be adversely affected by the combination.

**Reciprocity**

Looming over this subject is an important but difficult question. To what extent is all of this enhanced regulation about reciprocity, or tit-for-tat? The recent evidence is circumstantial and coincidental. What inferences can we draw from the fact that every review within SAMR of a U.S. acquisition slowed down when the CFO of Huawei was arrested in Canada for purposes of potential extradition to the U.S.? From the fact that Germany started to explore an expansion of its FDI regime after the U.S. blocked an acquisition by a German company? From the fact SAMR blocked the acquisition by Qualcomm of NXP after a 500-day review period that happened to include President Trump blocking the acquisition of Qualcomm by Broadcom. That the CFIUS process in the U.S. has become much tighter under a President who has said that trade wars are good and easy to win? We may never know for sure, but it doesn’t look good.