THE FRENCH DILEMMA: PRESERVING FDI IN FRANCE WHILE EXERCISING GREATER CONTROL

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The French Dilemma: Preserving FDI in France While Exercising Greater Control

By Marie-Laure Combet

While boasting of its (renewed) first place at the top of the ranking of attractive European countries from the point of view of foreign direct investments ("FDIs"), France has adopted various amendments to its FDI regime over the past three years, which have had as their effect to subject foreign investments to increased scrutiny but also, as a side-effect, to increased legal uncertainty. This move towards greater scrutiny is not surprising as protectionism is on the rise globally. But it may appear a bit contradictory with the objective to preserve France's attractiveness to FDIs. It hence raises the question of reconciliation between those seemingly contradictory intentions. In this article, it is suggested that an initial approach could consist in reducing the legal uncertainty currently faced by foreign investors subject to the French FDI regime. It may not solve entirely the dilemma, but it is undoubtedly part of the solution.

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I. INTRODUCTION

It is no mystery that, for some time now, sovereign states have been tempted by protectionism. This is reflected in a general strengthening of foreign investment control regimes, which must be given particular attention by any foreign investor wishing to invest in a so-called "sensitive" activity.

In the EU, this reinforcement has even been encouraged by the European Commission, which not only took the initiative in setting up a new EU filtering framework for foreign direct investment[2] ("FDI"), but also invited Member States that did not have such regimes to set them up, hence putting aside its traditional skepticism towards such measures due to their potential harmfulness to the EU internal market.[3]

France, which had not waited for this call to set up its own regime (its regime was already under periodic scrutiny by the European Commission, and had even inspired others, e.g. Italy), is no exception to this general trend towards a closer control of FDI. Between 2018 and 2020, various amendments to the French foreign direct investment control regime (hereafter, "FDI regime") had been adopted, namely: Decree n°2018-1057, *Loi Pacte* (Law n°2019-486), Decree n°2019-1590 and the related Orders, Decree n°2020-892, and Decree n°2020-1729 and related Orders.

Explicitly or implicitly, these amendments targeted the following main goals, namely:

- Strengthen the Minister of Economy's powers;
- Broaden the scope of his control by including new strategic sectors and investments; and
- Ensure the compatibility of the French regime with the newly introduced EU filtering framework on foreign investments.

However, while following this trend, the French government has not failed to regularly reiterate its concern that France should remain an attractive place for foreign investors.

This raises the question of how to reconcile two seemingly contradictory intentions. This article first offers a brief overview of the strengthened and extended French FDI regime, as well as its practical implications for foreign investors. It then raises the question of the reconciliation of a strengthened FDI regime with the Government's stated objective of preserving France's attractiveness in terms of FDI and suggests possible avenues that could be explored to improve the current situation.

II. A BRIEF OVERVIEW OF THE STRENGTHENED AND EXTENDED FRENCH FDI REGIME

A. Scope of the FDI Regime

In France, the principle of freedom to invest applies. Only certain foreign investments in sectors which are deemed strategic in consideration of the essential interests of the nation are subject to the Ministry of Economy's prior review. While this prior review was traditionally limited to the most obvious strategic sectors (namely, national security, defense (ammunition, weapon-related sector, dual-use materials and technology…), encryption, gambling, private security, sites of vital importance…), the list of sectors has progressively been enlarged along with the categories of investments concerned.

2 Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union.

3 Communication from the European Commission - Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (C(2020) 1981 final).

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For the FDI regime to apply, three cumulative conditions must be met:

- The investment concerned must involve a foreign investor. This condition is met by non-EU/EEA and EU/EEA (non-French) investors, it being specified that a French citizen, who is domiciled abroad for tax purposes, is deemed a foreign investor. More surprisingly, the condition is also met by an ultimate French based investor, to the extent the latter performs its investment through a chain of companies, including a foreign registered company.

- The investment concerned must fall within the categories of the so-called "foreign investments." Not all types of transactions are indeed caught. Three categories of investments are subject to the Minister of Economy's review (NB: one less for EU/EEA investors): 1° acquisition of (direct or indirect) control, within the meaning of Article L. 233-3 of the French Commercial Code, of an entity governed by French law; 2° acquisition of all or part of a branch of activity of an entity governed by French law; 3° crossing, directly or indirectly, alone or in concert, of the threshold of 25 percent of the voting rights of an entity governed by French law (instead of the former threshold set at 33 1/3 percent of the share capital or voting rights applicable until early 2020).[4] This is the latter category which does not apply to EU/EEA investors.

- The investment concerned must pertain to a French target engaged in a so-called strategic sector. The enlarged list of sectors now includes the following sectors (from the oldest to the most recently introduced ones):

  - Strategic activities as per Article R.151-3, I°, of the French Monetary and Financial Code: activities relating to products for military use, dual-use products and technology, national defense, encryption, including contractors and subcontractors of the French Ministry of Defence in these areas, devices for interception or remote detection of conversation or data, assessment and certification of IT security by approved assessment centers, gambling (other than casinos), measures to address the use of biological or chemical threats or to prevent the health consequences of such use;

  - Strategic activities as per Article R.151-3, II°, of the French Monetary and Financial Code: (*introduced 2014, enlarged in 2018 and 2019*): activities relating to infrastructures, goods or services that are vital to guarantee the integrity, security and continuity of energy supply, water supply, transport networks and services, space operations, electronic communications networks and services, public health; activities relating to infrastructures, goods or services that are vital to guarantee the integrity, security and continuity of public safety missions carried out by police, gendarmerie, customs, and other approved providers of security services the operation of a building, installation or of a key infrastructure (*ouvrage d'importance vitale*) within meaning of French Code of Defense, food safety, print and digital press, IT security services in relation to the operation of a building, installation or of a key infrastructure (*ouvrage d'importance vitale*) within meaning of French Code of Defense;

  - Strategic activities as per Article R.151-3, III°, of the French Monetary and Financial Code (*introduced in 2018, enlarged in 2019 and 2020*): activities relating to R&D on applications for the aforementioned activities, regarding: dual-use goods and technologies, cybersecurity, artificial intelligence, robotics, additive manufacturing, semiconductors, quantum technology, energy storage and biotechnologies.

Of these conditions, the third is undoubtedly the most challenging for foreign investors and practitioners when it comes to determining whether a contemplated investment falls within the scope of the French definition of an FDI. Indeed, absent any guidelines or publicly available decisions in that regard, the definition of certain sectors (in particular the recently introduced ones) remains rather vague and what may qualify as a "strategic" activity is subject to interpretation.

B. Implications for Foreign Investors and Powers of the Minister of Economy

When a contemplated investment is subject to the Minister of Economy's prior review, the foreign investor shall notify and obtain his prior approval before completing it.

A failure to comply with the obligation to notify and/or the standstill obligation can have serious consequences. Firstly, any agreement, any contractual documentation, by virtue of which the investment concerned is materialized is deemed null and void. Secondly, since the *Loi Pacte*, the Minister of Economy enjoys an important toolkit of burdensome injunctions *vis-à-vis* the foreign investor, with the possibility to impose

4 NB: this threshold has temporarily been lowered to 10 percent (until the end of 2021) for investments concerning French listed companies.

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penalty payments in case of non-compliance. Thirdly, the Minister of Economy may impose financial sanctions against the foreign investor, the amount of which is at most the highest of the following sums: double the amount of the irregular investment, 10 percent of the annual turnover excluding tax of the French target, five million euros for legal persons and one million euros for natural persons. Lastly, the foreign investor may also be exposed to criminal prosecution and criminal sanctions.

Once a notification is received, the matter is being handled by a special and dedicated division of the Treasury, the bureau in charge of foreign investments, which is part of the Ministry of Economy, and the ministries or agencies competent in the sector concerned (e.g. if the defense sector is concerned by the investment, the Ministry of Defense is involved in the process, if encryption activities are at stake, the ANSSI is generally involved).

The Minister of Economy may render a decision either in phase I, after a 30-working-day period after filing, or in phase II, after an additional 45-working-day period after the opening of the said phase II. Admittedly, the duration of the initial review period is shorter than before 2019 where a single two-month review period applied. But, at the same time, the potential additional review period, which applies in particular where the Minister intends to subject his approval to conditions, can render the overall review period significantly longer than before.

Decisions which may be taken by the Minister of Economy are the following: non-applicability decision (i.e. decision whereby the Minister eventually finds that the foreign investment is not subject to review); authorization without conditions; authorization with conditions; rejection and withdrawal of authorization. Silence kept after the expiry of the review periods amounts to rejection.

As for the conditions which may be imposed by the Minister of Economy and which have been specified in more detail by Decree n°2019-1590, they may be far-reaching, although in principle subject to the proportionality test. Four main categories of conditions are provided for: (i) those necessary to preserve, on the national territory, the security and sustainability of the strategic activity concerned; (ii) those designed to ensure that knowledge and know-how of the French target are protected and not subject to a "foreign capture"; (iii) those relating to the internal organization of the French target and its governance (including the way voting rights are being exercised); and (iv) those pertaining to the reporting *vis-à-vis* the Treasury. The aforementioned Decree also provides that the Minister's authorization may be subject to the sale, by the foreign investor, of shares or interests in the French target, or of whole or part of a branch of the French target, to a third party approved by the Minister.

When it remains unclear whether a contemplated investment is subject to prior review (in most cases, due to the vagueness of the definition of certain sectors), the foreign investor (or the target) has the possibility to formally request an opinion from the Ministry of Economy who has two months to respond.

For those familiar with pre-merger control procedures, the FDI review process may present, to some extent, some similarities, although the substantive assessment that is being performed in the FDI review is obviously very different. Like pre-merger requirements, FDI requirements shall also, when applicable, be duly considered in the transactional documentation and in the indicative timeframe of the transaction.

C. Control Over the Minister of Economy

Admittedly, the Minister of Economy enjoys a wide margin of maneuver when it comes to FDI review.

However, when exerting his powers, he may be subject to two types of control:

- The first type of control is the one exerted through the judicial review of his decisions. Indeed, as with any other administrative decisions, a foreign investor, addressee of an adverse decision, has a right to legal challenge. One must however admit that, in practice, this means of control is seldom used by foreign investors. Only a handful of judgments have been rendered since the FDI regime is in force.
- The second type of control is the one exerted by the French Parliament, although it shall be specified that it is only exerted *ex post* and is of purely political nature. The Government shall indeed report on its activities relating to the FDI review on a yearly basis. The designated representants of the National Assembly and the Senate may request hearings of the Minister of Economy and civil servants and launch investigations on the Government's actions. They may also make observations and issue recommendations to the Government.

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D. The Relationships with the European Commission and the EU Member States

While the FDI review had long been a topic of purely national interest, arousing as it has been said above the European Commission's skeptiscim, things can be said to have slightly changed since the entry into force, on April 10, 2019, of the EU filtering framework on foreign investments.

With the political announcements and the terms used ("filtering"), one could have expected a new and quite developed arsenal at the EU level regarding FDIs.

But, in the end, this initiative only led to a mere cooperation mechanism, far from a control regime at EU level, which would have added up with the existing national FDI regimes.

Although it is undoubtedly disappointing for the European Commission, which is relegated to a subordinate role of simple commentator (it can, like the Member States, issue an opinion to the Member State competent to review the FDI in question), one can think that this mechanism, which allows an exchange of information and of views between the competent Member State, the other Member States and the European Commission, put some additional risks and add some more uncertainty for the foreign investor, even if in this area there is no doubt that the competent Member States retain a very largely predominant role.

III. HOW TO RECONCILE THE OBJECTIVE OF PRESERVING FRANCE'S ATTRACTIVENESS WITH THIS STRENGTHENED AND EXTENDED FDI REVIEW?

While many factors contribute to a country's attractiveness to foreign investments, one cannot deny that the scrutiny facing such investments may constitute an important one.

In light of the current framework presented above, the question arises of how to reconcile the concern to preserve France's attractiveness to foreign investments with this strengthened and extended FDI review.

While boasting of its (renewed) first place at the top of the ranking of attractive European countries from the point of view of foreign direct investment,[5] France has indeed recently been singled out for two foreign investment "bans" that have been voluntarily made public by the French Government itself and largely advertised by the press.

The first ban concerned the offer to buy Photonis, a French SME specialized in optronic technologies, in particular for night vision binoculars for the French armed forces, by Teledyne, a US company specialized in electronics and engineering. According to the Ministry of armed force's press release,[6] the State's decision was "*motivated by the French government's strong desire to protect and guarantee French economic and industrial defense sovereignty*" and "*[i]n this case, the conditions for the takeover of Photonis did not meet these requirements*." From the press reports, it seems that the ban could have been the result of the refusal by Teledyne to adhere to the far-reaching conditions which might have been proposed to them by the Minister of Economy.[7] It is admittedly very difficult to give an informed opinion without knowing the details of the case, even more when the defense space, probably the most sensitive sector, is concerned. But, while bearing in mind this reservation, an outside observer might think that the Minister's stance was a bit harsh. Teledyne indeed has a strong presence in France and is moreover already a partner of the Ministry of the Armed Forces. It cannot be ruled out that this position took Teledyne a little by surprise.

The second ban, which is not technically a ban (because it is highly unlikely that the FDI review process has even begun), concerns a very different sector, that of food retail. It concerns the contemplated takeover of the French food retailer Carrefour by the Canadian Couche-Tard, also

5 See the Minister of Economy's press release dated June 7, 2021 "International investments: France remains the most attractive country in Europe," available at https://www.economie.gouv.fr/investissements-internationaux-france-reste-pays-plus-attractif-europe#.

6 Press release dated December 18, 2020 and entitled "Sovereignty of strategic companies: Florence Parly announces that the French government is working on an alternative solution for the takeover of Photonis."

7 According to the press, on the initial attempt by Teledyne to purchase Photonis, the following commitments would have been proposed by the Minister to Teledyne: allow for a minority stake in Photonis of the State-owned institution, Bpifrance (up to 10 percent) and grant veto rights regarding the operations and management of Photonis' European businesses in France and the Netherlands (see e.g. the press article dated October 27, 2010, published in Challenges and entitled "*Incroyable, l'américain Teledyne repart à l'assaut de la pépite française Photonis*" by Vincent Lamigeon).

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engaged in the food retail sector. Very quickly after the announcement of the opening of discussions between the two groups, the Minister of the Economy expressed strong opposition to the project on the grounds of national food security and did not hesitate to say that should the parties proceed with it, he would use his power to prohibit it in the context of the FDI review. Although it is permissible to question the legal robustness of the reasoning which would have enabled him to take such decision, this simple political statement had the desired impact since the parties quickly made it known that they were abandoning their project.

If it is true that those sensationalist bans may potentially have sent some bad signals to foreign investors, they are not (because of their political sensitiveness) the most representative and thus not the most detrimental in terms of image.

What is more detrimental is the increased uncertainty surrounding the current FDI regime, which also affects transactions that are less spectacular. This uncertainty has three faces:

- The uncertainty pertaining to the material scope of the FDI review which admittedly did exist to a certain extent in the past but has been worsened with the introduction of the new sectors. Their rather vague definition unquestionably leaves more room to interpretation. As a result, there is a multiplication of cases where a foreign investor must, to pre-empt any risk of failure to request a prior approval, request at minimum a prior opinion from the Minister.

- The uncertainty pertaining to the timeframe of a given transaction because of the potential implications of the FDI review. While timeframe is admittedly crucial for all transactions, it is even more crucial where the target is of a relatively small size and engaged in fast-moving technology markets where competition is fierce (including competition for tech talents). This time-related uncertainty arises in two types of situations: the first situation (which, as indicated above, has tended to become more and more frequent) is when there is doubt as to whether a given investment shall be deemed subject to the Minister's review as, depending on the latter's opinion, the Phase I review period (and potentially also the Phase II review period) may turn out to apply and delay completion of the transaction ; the second situation comes fromthe difficulty to anticipate from the outset, in particular in new sectors, whether the Minister will consider that conditions will be required and hence if the transaction will only be subject to a Phase I review period or also to a Phase II review period.

- The uncertainty pertaining to the potential conditions that may be requested from the foreign investor. As said above, those conditions may be very far-reaching and may be difficult to anticipate from the outset, in particular, in the new sectors. If it is true that the foreign investor can still pre-empt the risk of far-reaching conditions by providing for an outright exit right in the contractual documentation, he will have lost time and money in the process, not to mention the potentially adverse consequences for the target, which may find itself eventually worse off after this failure.

It cannot be denied that repeated attempts have been made by France to otherwise ensure that the FDI review process be quicker, smoother, and more straightforward.

Yet, the least that can be said is that there is still room for improvement.

What could be done to better address this uncertainty and hence better reconcile the strengthened and extended review with the quest for attractiveness?

Some possible avenues that could be explored are suggested below:

- Issue guidelines to clarify the scope of the most recent strategic sectors. As the decisional practice has developed over the last three years, the administration may have acquired sufficient experience to be able to give more precise indications as to what may be deemed "strategic." It would be even more important since, as said before, decisions are not publicly available, and the rare case-law is irrelevant for that matter.

- Shorten the two-month-period to issue an opinion as to whether a given investment is subject to review. In practice, this period is generally not fully used by the administration, which is more pragmatic and responsive, but this depends on its goodwill. For better predictability, a quicker response should not merely rely on the administration's goodwill but rather on texts.

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- Issue "best practices" on the FDI review. Those "best practices," which constitutes a tool used by the European Commission in various fields (state aid, merger control, antitrust proceedings…), provide a useful insight on the administrative practice in a given field. They would ensure a better stability in the administrative practice despite the natural turnover of civil servants in charge of the FDI review as changes in approach are often noticeable when teams are renewed.

While it is fully understandable that the protection of national interests may require the preservation of some margin of maneuver for the Minister of Economy in the context of the FDI review, it shall be no excuse not to go the extra mile to try to better tackle this lack of predictability. It may not entirely solve the dilemma facing France, but it is undoubtedly part of the solution.

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