

FOREIGN INVESTMENT CONTROL IN THE DEFENSE AND NEW TECHNOLOGIES SECTORS: FROM GEOPOLITICS TO GEOECONOMICS

Interview with Vincent Brenot and Julien Aucomte, Partners, August Debouzy



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Vincent Brenot



Julien Aucomte

What substantive differences do you observe between the control of foreign investments in the defense sector and in the new technologies sector?

Vincent Brenot: The defense sector has naturally been an early focus of Foreign Investment Control. The production of the equipment required to meet national defense needs and thus ensure that French sovereignty is preserved is undisputedly a critical area of activity.

New technologies have been brought into the scope of foreign investment control in a pragmatic manner, through ad hoc additions that started with decree No. 2014-479 of 14 May 2019 on foreign investments subject

to prior authorization, known as the “Montebourg Decree” (after the then Minister of Economy). Successive French governments have committed to identifying the sectors of activity that enable France to maintain its position in the concert of nations, not only on the military front, but also on the economic front, where innovation plays a decisive part.

This has been a global trend since the end of the Cold War. The major nations no longer compete to conquer territory nor, in a less clear-cut way, to extend their geographical spheres of political influence. Their rivalry is now being exercised through “soft power”, to quote Joseph Nye, in the economic field.

Therefore, Foreign Investment Control no longer targets States traditionally considered to be our “enemies”. It faces all international actors. Our military and diplomatic allies are at the same time our main economic rivals. Illustrating this development, the French authorities prevented in 2013 the proposed takeover of Dailymotion by the American Yahoo!. Dailymotion was owned by a French company at the time, and still is today (Vivendi).

The rise of the GAFAMs (Google, Apple, Facebook, Amazon and Microsoft) as entities with such financial strength that they can compete directly with States, even in certain areas traditionally considered as sovereign (see, for example, Facebook’s “Libra” project of a global digital currency or Jeff Bezos’ Blue Origin space shuttle), has made the new technologies an integral part of this global competition.

The GAFAMs and other tech champions are so often more advanced in the field of new technologies than States. On 23 April 2021, the French were rightly proud to see Thomas Pesquet take off for the ISS... still aboard a SpaceX rocket owned by Elon Musk.

States cannot compete with the GAFAMs and similar groups in terms of innovation and therefore need protect their homegrown tech startups. They do so by including the most innovative activities on the list of sectors where foreign investment is subject to screening. States thus use their regalian powers as a bulwark against the unprecedented financial power of these new private players; France is no exception to this underlying trend. It has, for instance, added biotechnologies to the list of sectors covered by Foreign Investment Control in 2020.

Screening foreign investments in the defense sector was a hallmark of the 20th century’s geopolitics. Screening foreign investments in the new technologies sector is a feature of the 21st century geoeconomics.

Last, defense and new technologies sometimes overlap. In such cases, national authorities are adamant; the American company Teledyne was made aware of this in December 2020 when the French Ministry of Finance vetoed its plans to acquire the French company Photonis, which specializes in optronics for defense.

What are the concrete implications of this trend on the screening of foreign investments in France?

Julien Aucomte: Historically, only M&A transactions, such as a 100% buyout by a foreign operator, or majority LBO transactions conducted by funds were screened. However, since decree No. 2019-1590 of 31 December

2019 came into force, any transaction causing a foreign investor to cross the threshold of 25% of voting rights in a French company engaged in sensitive activities is subject to screening. This threshold was even lowered to 10% for French companies whose shares are listed on a regulated market during the Covid 19 crisis (the mechanism was extended until 31 December 2022¹).

This highly restrictive 10% threshold was introduced to protect listed French companies, whose share prices could be hurt by the economic consequences of the Covid 19 pandemic, from the covetousness of foreign investors wishing to make low cost acquisition. It is therefore a temporary measure.

The 25% threshold, which is a permanent one, particularly affects the projects of certain sovereign wealth funds that are familiar with taking minority stakes, sometimes in technology sectors likely to be regulated.

This is also true of venture capital operations. There is a significant movement of foreign funds, particularly from the US, into the new technologies sector towards French start-ups. With the amounts invested, the 25% threshold can easily be reached. Investors are now aware of this issue in the context of venture projects.

In addition, apart from equity participation, private equity and venture capital operations are characterized by shareholder agreements which sometimes give significant veto rights to a foreign minority shareholder, such as rights on the definition of the strategy and the business plan (which defines the company’s strategic policy over a three-to-five-year horizon).

Do you identify any differences in the way defense and new technologies cases are handled in terms of the relationship with the French authorities?

Vincent Brenot: Traditionally, in matters involving a militarily sensitive area, the issue of Foreign Investment Control is addressed early on. It determines whether talks with the potential foreign investor can proceed. French defense contractors maintain close contacts with military authorities and, when considering entering discussions with a foreign company, consult with them before engaging in talks on a possible transaction.

When the technology or the sector concerned is deemed excessively sensitive, the military authorities have a de facto veto power over the contemplated transaction, which it is pointless to try and circumvent. In practice, this type of request therefore never makes its way to the Foreign Investment Control office.

¹ Decree n° 2021-1758 of 22 December 2021.

The process is rather different where new technologies are concerned. First, with a few exceptions, there are no established relationships between companies, which are sometimes startups, and the French authorities. As a result, there are limited prior exchanges that would make it possible to anticipate their position on a given case. Moreover, there are not always clear security implications associated with investments in new technologies companies. The assessment of the critical nature of the activity under consideration will be somewhat subjective.

In practice, the French authorities generally show a certain degree of flexibility in examining cases involving new technologies. They most often do not oppose foreign investments, but make them conditional on strong commitments, particularly in terms of maintaining R&D in France and continuing to perform contracts with French customers considered to be sensitive (government agencies or companies of vital importance).

The objective is to avoid depriving French Tech start-ups of the foreign equity they need while preserving national interests; it is a delicate balance to strike.

Finally, in the case of transactions involving activities that may fall within a “grey zone”, decree No. 2019-1590 of 31 December 2019 opens up the possibility of asking the Foreign Investment Control office for guidance. This procedure has proven to be highly useful in determining whether a company’s activities fall within the scope of foreign investment screening. It can be done prior to any transaction, or even during a private auction process to select a buyer (e.g., even before receiving firm bids from potential buyers, some of whom are foreign).

What other issues are typically raised during discussions on the commitments required from foreign investors in the new technology sector?

Julien Aucomte: In addition to the question of R&D and contracts with sensitive French customers that we have already mentioned, the control of data, described by some as the new “black gold”, raises serious concerns due to the fear of it being transferred abroad and accessed by foreign companies, sometimes close to their governments.

Such fears explain, for example, the growing interest in the issue of the sovereign cloud and the reluctance of various

States to allow a Chinese operator to participate in the deployment of the 5G network in Europe, for fear that China would have access to all the data that would pass through this network, some of which is highly strategic.

The issue of data control sometimes gives rise to very technical talks when discussing the commitments to be made by the foreign investor. So as to keep the negotiations as constructive as possible, the Foreign Investment Control office is now keen to involve the relevant departments in very open discussions with the investor and the target company.

While the office is always committed to protecting French interests, in accordance with its main purpose, it is no less pragmatic in finding solutions that make it possible to reconcile this protection with a capital input that is sometimes vital for the development of the company that benefits from it, within a timeframe that is consistent with the imperatives of the transactional calendar (the minister’s authorization is always a condition precedent to the closing of the transaction).

Another issue that may arise is the communication of the company’s activities to the French authorities and the presence of French nationals in its governance bodies, which may act as a relay to the administration. If necessary, these individuals have “confidential defense” clearance.

These requirements are sometimes criticized by some investors as an attempt by the French administration to interfere in the running of a private company; however, they are not as stringent as some obligations imposed by other countries in this respect.

The American proxy board system, for instance, is far more demanding for foreign investors, who may be compelled by the US Department of Defense to set up the equivalent of a management committee composed entirely of American citizens. This committee is responsible for the day-to-day management of the company. This system is designed to prevent foreign shareholders from gaining access to any sensitive information passing through the company they own. The foreign investor is thus reduced to collecting dividends, like a mere “sleeping partner”, with the proxy board acting as a powerful “sleeping pill”.