French Foreign Investment Prohibition of U.S. Deal Highlights Regime's Importance for International M&A

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We recently had a stark reminder that the French foreign direct investment regime is being enforced more rigorously, with direct implications for acquisitions of foreign (i.e., non-French) target companies that control directly or indirectly a French business.

U.S.-based company Flowserve Corporation announced in October the termination of its agreement to acquire the Canadian company Velan Inc. due to the prohibition by the French Ministry of Economy (the "Ministry"), as part of its foreign direct investment review process, of the indirect acquisition of two French subsidiaries of Velan. These subsidiaries manufacture critical parts for French nuclear submarines and reactors and were considered by the Ministry to be essential for France's nuclear deterrent capability.

This is the second known recent prohibition decision by the Ministry, following its rejection in December 2020 of the purchase by the U.S. firm Teledyne Technologies of Photonis International SAS, a supplier of night vision equipment to the French military. The Ministry blocked the Photonis transaction in order to protect the critical military use by France of Photonis' products, as well as to prevent Photonis ending up subject to the U.S. International Traffic in Arms Regulations ("ITAR"), thereby restricting its future export activity.

As a reminder, the French foreign direct investment rules generally require any foreign investor to obtain the prior authorization of the Ministry when it (i) acquires control, (ii) acquires all or part of a business line, or (iii) for non-EU/EEA investors, crosses the 25% threshold of voting rights in a French legal entity that carries on activities classified as sensitive under the law. The 25% threshold is reduced to 10% for French-listed companies.

Unusually in a foreign investment context, both of the blocked deals concerned U.S. buyers. More interestingly, such outright rejections are recent and very rare, although they do indicate more rigorous enforcement. The Ministry has usually preferred to impose conditions to safeguard French national interests. According to its annual report,[1] in 2022 the Ministry reviewed 325 files (which include both applications for investment authorization and requests for a ruling as to whether a French business activity requires a screening).[2] In total, the Ministry authorized 131 foreign investments in sensitive businesses, but 70 of those were subject to conditions.

Traditionally, the conditions imposed to preserve the national interest required the sale of shares or transfer of major assets of the concerned French business to another investor approved in advance by the Ministry. In 2022, however, in another case demonstrating a more hands-on regulatory approach, the Ministry demanded that, the French state receive a golden share in the French target (the "Golden Share"). The case involved the French company Exxelia International ("Exxelia") in which the U.S. aerospace and electronics company Heico ("Heico") acquired a majority stake.

Exxelia specializes in the design and manufacture of passive components and precision subsystems such as capacitors, magnetics, resistors, filters, position sensors, slip rings and high-precision mechanical parts widely used in industrial applications including aviation, defense or space. Given the sensitive nature of Exxelia's business, any foreign direct investment crossing the 25% threshold of its voting rights is subject to the prior authorization of the Ministry. The Golden Share received by the French state provides it with rights designed to preserve the state's interests in the strategic capabilities of Exxelia, and includes:

- the right to sit, without voting rights, on any deliberating body (such as a board of directors or a supervisory board) that could be created within the company;
- a veto right on any transfer or issuance of shares of Exxelia to a third party and on the transfer of at least 5% of the share capital to a member of a shareholder's group;
- a right of exclusion (or suspension of non-monetary rights) of any shareholder who, in the case of a change of control of such shareholder, breached the French rules on foreign direct investments;
- a veto right on the transfer of any sensitive activity conducted by Exxelia and its subsidiaries and on the transfer of the shares of any subsidiary of Exxelia conducting sensitive activities; and

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1 Report available in French or English at: https://www.tresor.economie.gouv.fr/Articles/2023/04/12/publication-du-rapport-annuel-sur-le-controle-ief-en-2022.

2 We believe that in most of these files, the Ministry concluded that the business activities involved did not require a screening.

- a veto right on any modification of the rights conferred by the Golden Share or when the law or the articles of association require unanimity.

This list of conditions from the Exxelia transaction to which a foreign direct investment might be subject is far from exhaustive. We have seen other jurisdictions impose broad obligations designed to ring-fence the target business and/or impose enhanced physical and cyber-security measures in addition to what Exxelia agreed to. Other corporate decisions we would expect the Ministry to consider subjecting to a veto right of the French state by virtue of a golden share could include the appointment of corporate officers and the conclusion of strategic agreements, provided that potential investors are willing to concede to ongoing oversight by the French state as a condition to their investments.


E. Raman Bet-Mansour
Partner, London
+44 20 7786 5500
rbetmansour@debevoise.com


Timothy McIver
Partner, London
+44 20 7786 5488
tmciver@debevoise.com


Philippe Tengelmann
International Counsel, Paris
+33 1 40 73 12 34
ptengelmann@debevoise.com


Rosanne Lariven
Associate, Paris
+33 1 40 73 12 95
rlariven@debevoise.com