IN
INTERNATIONAL NEWS

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SPOTLIGHT ON

FOREIGN INVESTMENT

A LOOK INSIDE

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IN

INTERNATIONAL NEWS

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In this dynamic global landscape, investors have always been required to make savvy, smart choices. This requires navigating through the intricate web of bilateral treaty protection, exploring the vital role these agreements play in safeguarding investments across borders. An example lies in the Energy sector, as the Energy Charter Treaty shapes international investment strategies.

In our latest issue of International News, we take a look across sectors and issues of concern to investors, exploring carve-outs and their strategic implications, a deep dive into the fascinating world of investing in sports—a realm where financial strategy meets passion and global markets converge. We focus on the burgeoning healthcare sector in Asia, analyzing the opportunities and challenges that come with investing in this rapidly evolving landscape. We address the pressing issues of currency volatility, anti-coercion measures, and the recently enacted Foreign Subsidies Regulation in the European Union. Together, these issues weave a rich tapestry of elements informing investment decisions in an ever-changing global economy.

Please contact the authors directly if you have any comments on our articles, or would like to discuss any of the issues raised.

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A QUICK GUIDE TO BILATERAL INVESTMENT TREATY PROTECTION

Michael Darowski and Romilly Holland

Bilateral Investment Treaties (BITs) contain important protections for foreign investors and should be considered carefully before structuring an investment.

BITs are agreements between two states regarding the treatment of investors from one state (the home state) investing in the other state (the host state).

BIT protection is especially important in high-risk jurisdictions These protections include, most critically, the possibility of resolving any disputes that arise between the investor and the host state before a neutral, international arbitral tribunal.

THE RISKS OF FAILING TO CONSIDER BIT PROTECTION

BITs are designed to foster investment and therefore set out the standards by which foreign investors can expect to be treated by the host state. The protections afforded by BITs are particularly important if the investor does not have an underlying contract with the host state.

> **BITs are designed to foster investment.**

The real "strength" of a BIT is the investor's recourse to international arbitration in the event of a dispute with the host state. International arbitration results in a final and binding award with which states typically comply. Failing such compliance, investors can rely on a number of international instruments to ensure the award is recognised and enforced. Without the recourse afforded by a BIT, the investor may become embroiled in expensive, lengthy and complex proceedings in the host state before its national courts, which can be hostile to such claims.

Investment protection is, above all, a risk mitigation tool and, conversely, the perils of failing to make use of it are considerable. By way of example, a US investment fund with a 75% holding in a hydroelectric plant in an East African country had a dispute with the state regarding the application of capital gains tax when the fund decided to dispose of its holding. The fund had not structured its investment so as to benefit from BIT protection, including international arbitration, meaning that its sole means of resolving the dispute was before the local tax courts. Perhaps unsurprisingly, the courts were not sympathetic to the investor's case. Had the investor structured its investment with due regard to BIT protections, it would likely have been able to bring a claim against the state with regard to the tax treatment of its investment before an international tribunal.

> **Investment protection is, above all, a risk mitigation tool.**

HOW TO SECURE BIT PROTECTION

Investors should identify and compare applicable BITs, i.e., BITs to which the state they are investing in is party, and structure the investment through the jurisdiction that will afford the investor optimal protection.

This should be done at the outset of the investment, with the situation continually monitored throughout its life as they can often be re-structured to improve the protections available. It is doubly important to proactively assess possible improvements, as restructuring designed to access international arbitration once a dispute has arisen risks being considered as abusive "treaty shopping".

It is vital to examine carefully the protections afforded by each applicable BIT and work with a trusted advisor to tailor a bespoke Treaty that suits the individual needs of each investment.

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NAVIGATING THE ROUGH WATERS AROUND THE ENERGY CHARTER TREATY

Stefano Mechelli and Lisa Richman

Investing in energy at the international level requires extra care and expert advice, particularly given the uncertainties generated by attempts to reform or terminate the Energy Charter Treaty (ECT).

The ECT is a multilateral, international agreement that establishes a framework for co-operation and investment in the energy sector. It has been in place since the late 1990s and has come under some criticism, particularly in relation to the following two key issues:

1. Its investor-state dispute settlement (ISDS) mechanism, which allows foreign investors to sue governments or government-owned entities for alleged breaches of the Treaty, is seen as unacceptable to the European Union after the European Court of Justice (ECJ) decision in *Moldova v Komstroy* (C-741/19). The ECJ held that the ECT's ISDS mechanism does not apply to intra-EU disputes.
2. Its sunset clause, which extends for pre-termination investments the availability of arbitration under the ECT for 20 years after termination.

THE MODERNISATION PROCESS

The European Union had been pressing for a number of years for the modernisation of the ECT, which led to an "agreement in principle" addressing a number of issues, including

- The possibility of carving out investments in fossil fuel and providing greater support for clean energy transition and climate-change related policies
- The exclusion of intra-EU disputes from the ISDS mechanism
- The strengthening of the right to regulate and narrowing of the ability to arbitrate.

WITHDRAWAL PLANS

Following Italy's isolated withdrawal from the ECT in 2016, a number of other EU Member States have recently followed suit (or threatened to). The European Union is also re-evaluating its position.

This action has often been justified by a dissatisfaction with the modernisation efforts, both in terms of timetable and achievable results, particularly as they relate to climate change. These debates contributed to postponements of the final vote on the modernisation in both November 2022 and April 2023.

Notably, withdrawal from the ECT triggers the 20-year sunset period, while modernisation might bring about quicker changes, particularly as they relate to fossil fuels.

CO-ORDINATED WITHDRAWAL

On July 7, 2023, the European Union called for a "co-ordinated withdrawal" by the EU, EU Member States, and the European Atomic Energy Community. The aim of the withdrawal seems to be to 1) free the European Union and its Member States from their treaty obligations for future investments, while 2) agreeing to eliminate the sunset period for existing investments.

The second objective is, however, highly debated both politically and legally, particularly in relation to the effectiveness of *inter se* agreements targeting the sunset clause in a multilateral treaty.

> On July 7, 2023, the European Union called for a "co-ordinated withdrawal".

ROUGH WATERS

For energy investors, particularly intra-EU investors, these are complicated waters to navigate. The changes are imminent and demand prompt action, but the potentially available protections are difficult to predict given the multiple alternatives and the absence of a clear path forward.

The final word may be left to arbitral tribunals, which means the full scope of these issues may not be known for a number of years.

Energy investors would be well served to seek bespoke advice regarding the scope and structure of their investment(s), and the dispute resolution options available to them, before an issue arises.

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CROSS BORDER AND MULTI JURISDICTIONAL CARVE-OUTS: Perspectives of a Private Equity Buyer and Strategic Seller

Sam S. Snider and Andrew J. Warmus

There are a number of challenges encountered by private equity (PE) buyers and strategic sellers in carve-out transactions that can be easily avoided by each side understanding the perspectives of the other from the outset.

Corporate carve-out transactions can be complicated, administratively burdensome and difficult to execute well. These difficulties become particularly pronounced where a corporate seller without significant experience in PE transactions divests a global business to a PE buyer with a minimal global footprint and limited cross-border experience. As a result, corporate carve-outs have historically been the domain of specialised groups with deep experience in the area.

DEFINING THE DEAL PERIMETER

Challenges in cross-border carve-outs frequently arise before a deal has even begun because corporate sellers often define a transaction "perimeter" using an internal allocation methodology for financial reporting purposes. This may inadvertently exclude key aspects of the carve-out business because the "business" was not designed from the ground up and the specific assets and personnel dedicated to it are not readily apparent from a financial statement-derived transaction perimeter.

These differing perspectives can have real, practical implications. Corporate sellers often view materiality in the context of the overall enterprise and take for granted the extent of their internal resources, whereas PE buyers (especially in the middle market) can view materiality based upon the stand-alone "business", and discount the importance of the larger corporate infrastructure. In that scenario, both sides can devote significant time and resources to a transaction based upon disparate assumptions and become genuinely surprised late in the process by the actual cost, effort, and timeline required to complete the transaction. Where one side is materially more surprised than the other, deals can fall apart.

It is, however, unreasonable to assume perfect information will be available at the outset. Completed carve-out financials and detailed asset mapping are the most difficult aspects of a carve-out transaction and invariably come later in the process. Further, the myriad structural solutions to facilitate more complicated separations continue to make it more likely that sellers will defer the most granular analysis. But there are ways to bridge this gap.

CONFIRM THE TRANSACTION STRUCTURE AND REQUISITE FOOTPRINT

Because corporate carve-outs are often structured as asset purchases, buyers may need to establish a legal entity in each jurisdiction in which assets will be transferred and effect separate local conveyances. While entity formation is trivial in many countries, it can be a time-consuming process in others, particularly countries that have both minimum capitalisation requirements and exchange control processes requiring central bank approval for the domestication of funds.

Despite PE buyers' understandable reluctance to begin the entity formation process before a deal is signed, parties are often taken by surprise when longer lead-time closing conditions— such as competition approval—are completed, but the buyer does not yet have legal entities available to receive assets or employees. The mechanisms to address this, such as staggered closings, professional employment organisation (PEO) arrangements, fulfillment agreements, etc., can be complicated, costly and require extensive internal approval processes for corporate sellers. It is essential, therefore, for PE buyers and corporate sellers to discuss these basic structural matters as early as reasonably possible to avoid having something as basic as entity formation delay the closing.

> "Both sides frequently underestimate the scope, duration and cost of the transition services.

IDENTIFY LOCAL LABOUR REQUIREMENTS

Employee transfers in multi-jurisdictional asset deals are almost always more complicated than the parties anticipate. One obvious source of complexity is that M&A-related employment laws vary dramatically from country to country.

For instance, many countries have automatic transfer or "acquired rights" laws, such as the Transfer of Undertakings (Protection of Employment) regime in the United Kingdom, which provide a range of rights to employees—including automatic transfer of their employment—if an entire business undertaking changes hands. In other instances, personnel transfers can implicate both statutory and contractual severance obligations and material pension funding obligations. Further, if a buyer intends to utilise PEO solutions in a particular country rather than building the infrastructure to hire employees directly, the buyer must validate the availability of such an arrangement

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and its terms and conditions, as PEOs are reluctant to assume risks arising from acquired rights.

Similarly, many countries have employee consultation requirements in connection with the sale of a business, which can afford employees resignation rights and trigger (sometimes heightened) severance obligations. Beyond the obvious timing and public announcement implications, the parties must allocate the costs of severance and the business risk of material resignations, which could be fatal to a buyer's ability to operate the business.

Corporate sellers, whose HR departments are already familiar with applicable local laws, can significantly improve the efficiency of carve-outs by involving their HR and legal teams with PE buyers early in negotiations.

ASSUME FAIRLY SIGNIFICANT TRANSITION SERVICE REQUIREMENTS

In multi-jurisdictional carve-outs, both sides frequently underestimate the scope, duration and cost of the transition services that will be required. For instance, the timing of an employee transfer may be driven by how long it takes to form an entity and establish payroll and statutory retirement plans, or just to open bank accounts. While sellers can often make accommodations through deferred transfers and transitional arrangements, the costs can be material. At a minimum, a buyer will be expected to pay the seller's full cost to retain employees covered by such an arrangement, which can delay any modeled or required synergies.

While at first glance this appears to be an HR issue, the root cause may relate to treasury or IT dependencies. Unfortunately, it is not uncommon to see late-deal hiccups stemming from transition planning being led by functional teams that may not be aware of the timing, or even the existence, of these types of dependencies in unfamiliar jurisdictions.

This difficulty is further compounded by a trend in PE buyers seeking longer-term "transition" support to implement fundamental changes to the business's operating model, such as consolidating or shifting operations to lower cost jurisdictions. These arrangements can become very close to full-scale business process outsourcing agreements with complex service level agreements, relationship management mechanisms and financial reconciliation procedures.

REMAIN OPTIMISTIC

All these challenges arise from a disconnect in assumptions relating to the post-closing operations of the business and local idiosyncrasies associated with effectuating the deal and, as such, are easily avoided.

PE buyers can help avoid these issues by recognising the need for careful jurisdiction-by-jurisdiction planning and by sharing material transition and post-closing operational assumptions with buyers as early as reasonably practicable.

Corporate sellers can facilitate the transaction by ensuring careful construction of the business perimeter. They should also actively engage functional leaders, not just their M&A leads, to identify all dependencies necessary to transition their function, and make those leaders available to buyers early in deal negotiations.

Ultimately, the more clearly the parties can articulate their respective material assumptions and requirements, the lower the likelihood of disruptions delaying or killing a transaction.

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> "Corporate sellers can significantly improve the efficiency of carve-outs by involving HR and legal teams early.

INVESTING IN PROFESSIONAL SPORT

Thomas P. Conaghan and Greg C. Berson

As the data shows astronomical returns on investment for owners over recent years, the competition for sports teams is no longer between wealthy billionaires and their family offices, they are now also battling against institutional investors to obtain the prized possession of a prestigious team.

Professional sports teams are synonymous with prestige, entertainment and, now more than ever, rising valuations. In the United States, there are four dominant professional sports leagues: National Football League (NFL), National Basketball Association (NBA), National Hockey League (NHL) and Major League Baseball (MLB). These leagues are comparable with the economics and stature of other sports leagues across the world, most notably the top football/soccer and baseball leagues such as the English Premier League, Spanish La Liga, and Japanese Nippon Professional Baseball, or cricket's Indian Premier League.

As the price of, and return on investment in professional sports continues to rise, the investor pool has expanded from individual billionaires to private equity firms, sovereign wealth funds, and other institutional investors looking to cash in on this lucrative, yet scarce, asset class.

WHY ARE SPORTS TEAM VALUATIONS INCREASING SO DRAMATICALLY?

Media Rights

There are many lucrative income streams from a sports team, such as sponsorships and in-game ticket sales, but the over-riding factor driving valuations is media rights. Streaming behemoths such as Apple and YouTube have joined the fray to fight alongside sports media stalwarts such as ESPN, Fox and NBC for the right to air high profile games. The NFL's 2021, 11-year television deal, for example, is reportedly worth over US$110 billion.

> "The over-riding factor driving valuations is media rights.

Self-Fulfilling Prophecy

Investors are taking notice that nearly every owner that sells an investment in a top tier sports league, despite many teams incurring a financial loss on an annual basis, makes a significant return on investment. Dan Snyder bought the Washington Commanders for US$800 million in 1999 and sold for US$6.05 billion in 2023 to a consortium led by Josh Harris. Roman Abramovich bought Chelsea FC in 2003 for US$233 million and sold for US$3.2 billion to another consortium led by Todd Boehly and Clearlake Capital. Both owners left their respective clubs during tumultuous times, but this did not stop them reaching record-breaking prices.

WHAT ARE THE LEAGUES DOING TO FACILITATE INVESTMENT?

In 2019 the MLB, and in 2021 the NBA and NHL all instituted policies governing private equity (PE) fund investment in their respective teams, thereby creating clear paths to investment. Although they are enabling PE fund investment, they are also taking steps to ensure that they don't become 100% fund-owned or controlled. For example, the NBA, NHL and MLB limit to 30% the total amount of ownership by any amount of funds in one team. Further, there are control restrictions such as a five year minimum hold period, and a consent requirement for changing the fund manager in some cases.

In late 2022, the NBA implemented its institutional investor policy, paving the way for institutional investors such as sovereign wealth funds and pension funds to invest in the NBA. While other US leagues are open to and have received investment from institutional investors, *e.g.*, Qatar Investment Authority's investment in Monumental Sports & Entertainment, owner of the NBA's Washington Wizards and NHL's Washington Capitals, the NBA is the only US league thus far to codify such a policy. Investments by these new sources are more passive than a standard minority owner, which is a large part of the attraction for existing owners.

This approach differs slightly from European football leagues, which allow majority ownership by investment funds, including sovereign wealth funds, *e.g.*, the Saudi Public Investment Fund's majority ownership of Newcastle United, but still aim to limit fund control over a team.

The NFL, widely understood as the top sport based on revenue in the United States and possibly the world, continues to bar fund investments in its teams.

THE UNITED STATES V THE REST OF THE WORLD

There are substantial differences between US professional sports leagues and those in other countries.

The NBA, NHL and NFL all have a salary cap limiting the amount that teams can spend on base salaries, bonuses and other performance incentives. This promotes parity across the leagues and limits owner expenses and financial risk. The negative (or positive, depending how deep an owner's pockets are) outcome of this is that an owner wishing to spend more on players is prevented from doing so.

As institutional investors are often extremely cautious, the inability to control salaries and transfer fees has many shying away from leagues without a salary cap, such as MLB.

There are still workarounds to a salary cap. For example, the NBA's Golden State Warriors have paid more than US$170 million in "luxury tax"—the amount owed for payments above the salary cap—to retain superstars Stephen Curry, Klay Thompson, and Draymond Green. At the end of 2022, Sportico valued the Golden State Warriors at US$7.56 billion, a 25% year-over-year increase, so many would agree that US$170 million was money well spent. The money paid as luxury tax, under the current NBA collective bargaining agreement, is shared among the non-tax paying teams in the league at the NBA's discretion, in theory to level the playing field.

Investments May Go Down As Well As Up

The biggest difference between US and UK leagues from an investment point of view is the threat of relegation. In the United States, if a team does poorly, they are given the advantage of the first picks in the subsequent year's draft. In the United Kingdom, if a football/soccer team finishes bottom of the league,

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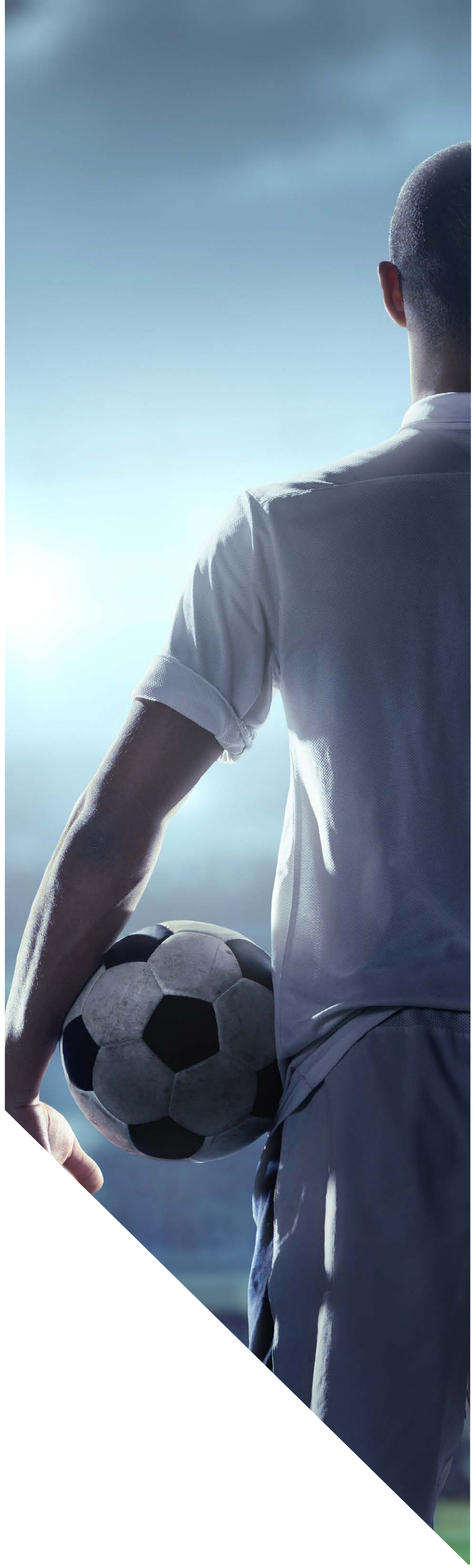

they are relegated to the next league down. And while this may be an emotional blow to the players and fans, it can be disastrous for the owners. With relegation comes loss of the shared league revenues related to broadcasting and sponsors, plus the general exposure that comes with a more prestigious league.

> There are still workarounds to a salary cap.

The converse also applies. There is a reason that the English Championship League's final match, where the winner is promoted to the English Premier League, is famously referred to as "the richest game in football." If an investor is looking to bring an underdog up the ranks, a European football club may be just the ticket, while a US professional sports team would better suit a more cautious investor.

As the valuations grow, so do the investment opportunities. You just need to be ready to move fast and have wealthy partners on standby, and a professional sports team could be yours for a figure in the low US$billions. Or you can take a page out of Ryan Reynolds' handbook and spend US$millions on a club like Wrexham FC. You could grow with the team, monetising it along the way through media deals, sponsorships and maybe even good performance on the pitch.

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ASIA HEALTHCARE AND LIFE SCIENCES TRENDS: What to Look Out for in 2024

Siddhartha Sivaramakrishnan

The Asian Life Sciences sector continues to present attractive growth opportunities, with regional and international healthcare businesses, innovation and research and development (R&D) platforms and strategic and financial investors all showing significantly increasing interest.

> Government bodies are actively promoting collaboration with global industry.

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There are a number of factors that make the Asian Life Sciences sector an attractive investment opportunity. Many Asian countries have, or will soon have, rapidly aging populations, driving demand for a range of healthcare and ancillary services for the elderly. In addition, as lifestyles change and rapid urbanisation continues in emerging Asia, the prevalence of chronic conditions requiring treatment and care management over the longer term is increasing.

Furthermore, as Asian populations become more affluent, in addition to healthcare and related innovative treatments they are increasingly willing to spend on ancillary services, such as wellness, nutrition and senior living. This will create new market and investment prospects allied to primary healthcare and life sciences opportunities.

This increase in wealth is also fueling the rapid spread of health insurance coverage across Asia, with take-up increasing as demand and incomes rise. In addition to basic public schemes available across some Asian countries, many global private insurers are now providing significant additional coverage, making it viable for healthcare providers to expand services, including more complex diagnostics and treatments.

In terms of relative priorities, and therefore opportunities, for investment, the region can broadly be divided into China for biotech innovation; Singapore for Asia Pacific manufacturing, distribution and R&D; South Korea for manufacturing and biotech development; Japan for pharmaceutical exports and India for generics and vaccines production.

GOVERNMENT SUPPORT AND REGULATORY REFORMS

Most Asian governments have recognised the importance of the Life Sciences sector as a driver for business growth that also can help them address healthcare policy challenges in their home countries. As a result, it's likely that there will be a continuation of policies that encourage healthcare innovation. These include expedited drug approval processes, manufacturing incentives and R&D support. Given the inherent benefits, it can be expected that cross-pollination across universities, bioscience companies, and government-supported funding incubators to monetise innovations will continue.

Government bodies are also actively promoting collaboration with global industry and funding research partners to share healthcare expertise and monetise life sciences IP. While certain markets, such as Singapore, Korea and Taiwan, have the industry, research and business infrastructure to drive and export their own life sciences innovations, several others will need continued access to overseas healthcare knowledge, products and technology. The healthcare regulatory efforts in Asia will continue to be focused on easing the path for international life sciences businesses to access and tap into sustainable revenue streams in these markets.

FOCUS ON BIOTECHNOLOGY AND PRECISION MEDICINE

Biotechnology, including gene therapy, cell therapy and genomics, has gained significant attention in Asia and there has already been considerable investment in biotechnology R&D. Genomics is a particular focus, given that the genomes of several Asian populations have not yet been fully mapped to develop genomic infrastructures for personalised healthcare for those populations.

Precision medicine tailored to individual genetic makeup, particularly in oncology, will become a major area of focus as these infrastructures are explored, presenting substantial "ground floor" investment opportunities. Asia has already seen a sharp rise in biotech startups focused on developing novel therapies, diagnostics and technologies in areas such as gene editing, regenerative medicine, and biomarker discovery and investment is welcomed in the research, diagnostics and therapeutics fields.

DIGITAL HEALTH AND HEALTHCARE TECHNOLOGY

The rapid advancement of digital technologies has led to a surge in digital health and healthcare technology startups in Asia, all hungry for investment. These startups are leveraging technologies such as artificial intelligence (AI), telemedicine, health monitoring devices and health data analytics to improve healthcare delivery, medical imaging analysis, diagnostic support, tailored treatment recommendations, patient outcomes and cost efficiency.

Historical underinvestment in physical healthcare infrastructure, and a highly dispersed and substantially rural population across Asian countries is driving a demand for telemedicine platforms and remote healthcare solutions. There has been a similar surge in mobile health applications that provide health information, track fitness and wellness, and offer remote monitoring capabilities. In conjunction with wearable devices, these offer attractive prospects for accessing large customer datasets for analytics and cross-selling.

IMPACT INVESTING

A trend towards impact investing reflects a broader shift towards responsible investments and the recognition of healthcare's potential for positive social impact.

Key opportunities for impact investors include healthcare infrastructure, such as clinical facilities and telemedicine platforms, as well as the development and scaling of affordable healthcare solutions in Asia. There is substantial demand for investment in low cost medical devices and generic drugs, as well as funding for digital health startups, healthtech platforms, and AI applications.

A key driver of investing in this space is alignment with the United Nations' Sustainable Development Goals (SDGs), particularly SDG 3: Good Health and Well-being. Focus outcomes in Asia include reducing maternal and child mortality, combating infectious diseases and promoting universal healthcare coverage.

INVESTMENT CHALLENGES

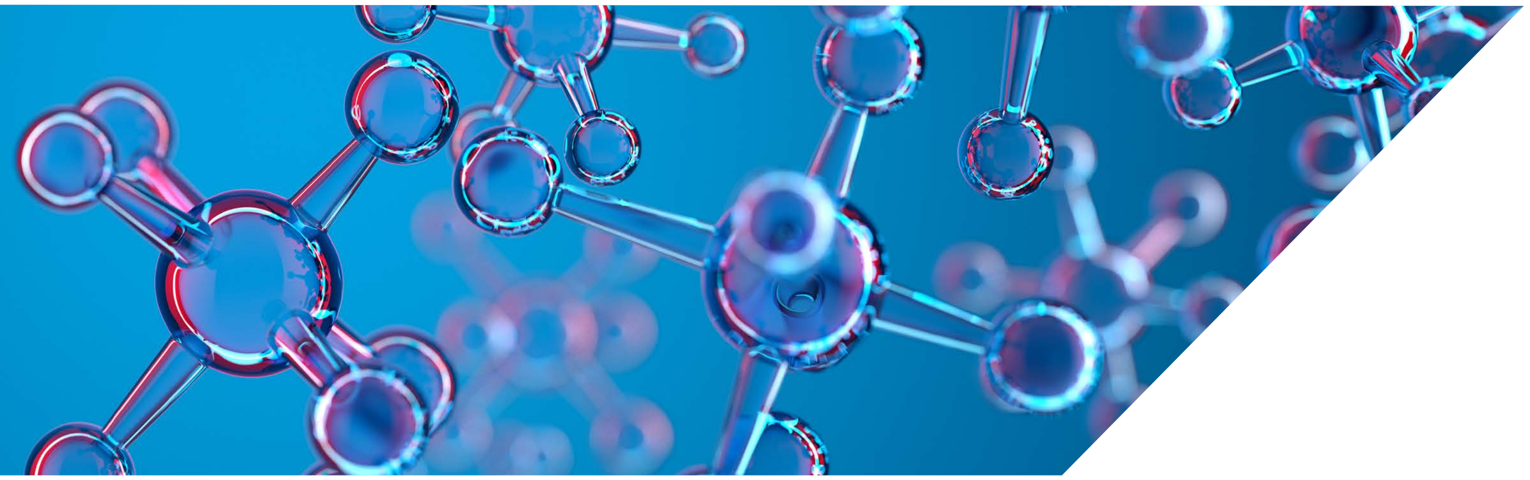
Notwithstanding investment growth drivers, there are several challenges for healthcare investments in Asia. Chief among these are regulatory barriers, including restrictions on foreign ownership, licensing requirements and pricing controls. Foreign ownership restrictions obviously vary from country to country, but in general there is a strong push towards localising bioscience R&D and drug manufacturing. In addition, generating and monetising healthcare data is proving challenging in the face of competing personal data privacy and security considerations.

Intellectual property protection for innovative healthcare technologies and treatments can be relatively weak in some Asian countries. Concerns about protecting and enforcing IP rights remain elevated in markets such as China and India, while others, such as Japan and Singapore, have very well developed regimes.

It is also notable that Asia is a highly diverse and dispersed region, with many different submarkets ranging from advanced and emerging economies. The region is also affected by increased geopolitical instability, making it more challenging to predict the medium to long term profitability of healthcare and life sciences investments, which depend on access to global knowledge, investors and markets.

Investors need to weigh these considerations carefully in light of their specific objectives and against the overall backdrop of significant growth in the Asian Life Sciences sector, driven by the region's increasing healthcare demand, government support, focus on biotechnology, digital health advancements and impact investing trends.

> "It's likely that there will be a continuation of policies that encourage healthcare innovation.



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HEDGING CURRENCY VOLATILITY RISKS IN CROSS-BORDER M&A DEALS

Vlad Maly

Cross-border mergers, acquisitions and sale transactions will inadvertently involve dealing with more than one currency. One option for managing the pitfalls of foreign currency (FX) fluctuation during a deal is to hedge the risk.

Managing FX fluctuation risk is an important part of the overall considerations that any M&A or investment team need to be familiar with.

Private equity sponsors in particular will be focused on the purchase and sale FX risk. Whenever a buyer or seller are entering into a sale and purchase agreement that is denominated in a currency that is different to the currency in which the sponsor draws on the limited partners commitments, or the currency in which the limited partners need to be repaid, the exchange rate fluctuation between the relevant currency pair can create uncertainty. This is because the amount needed from the limited partners to close the transaction, or the amount ultimately repaid, will depend on the then available FX rate.

A typical example of this situation would be when a US based private equity fund with commitments denominated in US dollars enters into a sale and purchase agreement with respect to a European target where the purchase price is denominated in Euros.

Ongoing FX risks linked to the investment will also arise if the target company operates in multiple currencies, or as part of the financing package the sponsor obtains financing in a currency different to the operating currency of the target. The anticipated exit will also pose long-term FX problems. At exit, the sponsor would need to purchase US dollars to convert the invested amount from Euros, but relatively minor movements in the FX rate at the time when the sponsor decides to divest from the investment may significantly impact the overall return on the investment.

> "The anticipated exit will also pose long-term FX problems.

To mitigate the FX risk with respect to the purchase, the ongoing operations, or sale, parties can hedge by entering into various bilateral over-the-counter hedging contracts with financial institutions. There are effectively two main categories of products available to hedge FX risk in this context: forward purchase transactions and options.

FORWARD PURCHASE TRANSACTIONS

The spot FX market generally operates on a T+2 (two business days after the day of the transaction) settlement basis. Any purchase of currency with a delayed settlement (longer than T+2) is therefore considered a forward transaction. FX forward gives parties certainty at the time of entering into the transaction that the currencies will be exchanged between the parties to the forward at a pre-agreed forward rate.

The Forward rate will be either higher or below the spot rate, as the rate will reflect the "forward points", which will be added to the then current spot rate and reflect market expectation as to how the FX rate will move between the time when parties enter into the forward transaction to lock the FX rate, and the date on which the currencies will be exchanged.

OPTIONS

Options, on the other hand, give the "option buyer" a right, but not the obligation, to purchase a specified amount in a specified currency at a pre-agreed exchange rate.

Options therefore allow parties to establish a floor with respect to the FX rate, giving the purchaser of the option protection against the FX rate deteriorating, while benefiting from the upside if the FX rate improves. Unlike forward, options typically require that the purchaser of the option pays to the seller of the option (a financial institution) an upfront payment at the time of entering into the option contract.

Hedging the FX risks *via* forwards and options is particularly problematic when, between signing the purchase contract and closing, there are requirements to obtain various regulatory approvals or to satisfy complex conditions precedents that could significantly delay closing. For example, on a complex M&A deal involving a sale of a subsidiary, the acquisition could involve carving out a particular business, setting up separate IT systems, and obtaining antitrust clearances in a number of jurisdictions. The timing of closing and the ability of the parties to satisfy the conditions precedent is therefore very unpredictable.

Regardless of whether a private equity sponsor decides to hedge the FX risk *via* a forward transaction or an option transaction, both will ultimately result in costs being allocated to the deal that need to be covered even if the underlying transaction doesn't ultimately close. Incurring such costs is problematic, as sponsors generally do not have access to their investment fund for costs incurred on a transaction that does not complete.

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DEAL CONTINGENT PRODUCTS

To address this issue, since the early 2000s banks have started offering products that are designed to be "deal contingent". Both deal-contingent forwards and deal-contingent options can be used to hedge the FX fluctuation risk between the signing and closing. Unlike plain vanilla hedging transactions, deal contingent transactions do not require parties to make any payments unless the transaction actually closes.

The exact nature of the "contingency" is negotiated between the hedging parties on a deal by deal basis and is tailored to the specific facts and circumstances of the transaction. The banks offering these products are prepared to analyse the contingency of a specific deal in order to price the costs of offering a hedge on a contingent basis. They charge the customer for taking the contingency risk, and that "contingent charge" (or "contingent points") is built into the FX rate or the premium that becomes payable if and when the underlying transaction does close.

While these products are inherently more expensive than plain vanilla hedging products, they provide sponsors with much needed certainty.

These transactions tend to be documented on "long-form confirmations" without the need for parties to negotiate and sign up front any ISDA Master Agreement. The practice of using a long-form confirmation does not, however, completely avoid some level of negotiation when it comes to documenting these contracts. A long-form confirmation incorporates

> "These products are inherently more expensive than plain vanilla hedging products.

all the terms of an ISDA Master Agreement as if the parties had actually signed the ISDA Master Agreement. As a result, any deviations from the ISDA Master Agreement that are required in the context of these specific hedging contracts need to be negotiated and set out directly in the long-form confirmation.

In particular, parties need to carefully consider how any "Events of Default" or "Termination Events" under the ISDA Master Agreement that automatically apply to such transactions should be treated during the contingency period. There is a natural tension between how deal contingent hedging operates if no bespoke amendments are introduced in the long-form confirmation, and what might be the parties' expectations as to how the contract should react to a situation if one of the parties ends up facing an insolvent counterparty.

As these hedges are bespoke, over-the-counter products, they do require careful thought from counterparties, who should seek expert advice on both structuring and documentation.

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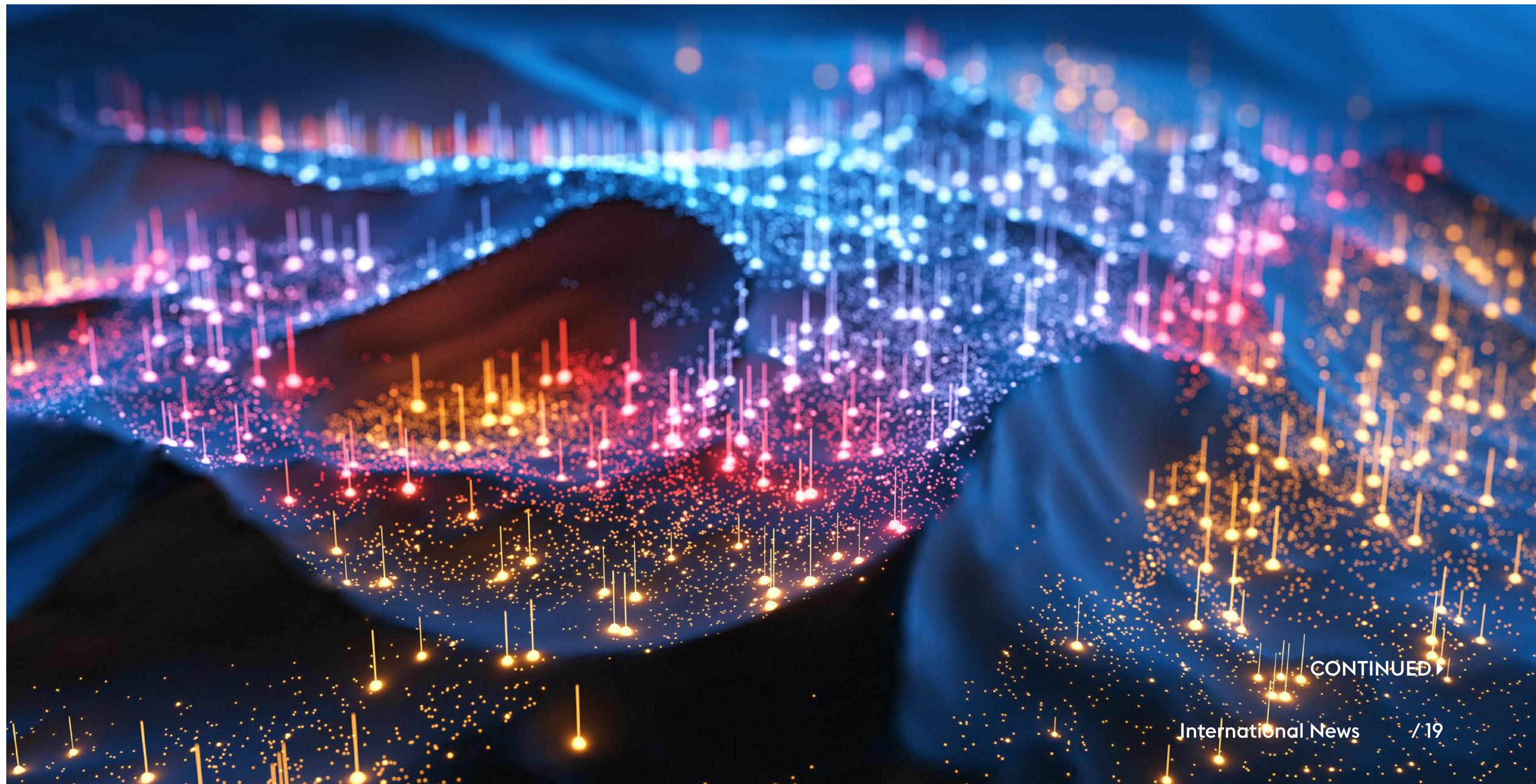
STRENGTHENING EU ECONOMIC SECURITY:
The Anti-Coercion Regulation and Outward Investment Control Initiative

Sabine Naugès

"Economic security" has become a political objective aimed at preventing third party companies or states from taking advantage of the opening up of the European market to acquire companies or technologies considered strategic or sensitive.

After the considerable extension of foreign investment screening in EU Member States, and the recent entering into force of the Foreign Subsidies Regulation, which obliges non-EU companies to declare public subsidies they receive before bidding for public contracts or taking over European companies, several recent announcements made by the European Commission show its willingness to pursue the objective of strengthening the economic security of Member States.

In this context, two new EU legal instruments could have major implications for European and non-European companies and investors operating on the internal market: the Anti-Coercion Regulation (ACR) and the potential outward investment control initiative.



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> **“Its primary aim is to defuse certain coercive economic practices employed by third countries.**

THE ANTI-COERCIAN REGULATION

After several years of discussion, the ACR was adopted on 22 November 2023. The Regulation aims to protect Member States from economic pressures that could be exerted on them by third countries, by providing a set of retaliatory measures that can be implemented at European level.

Its primary aim is to defuse certain coercive economic practices employed by third countries to affect trade or investment in order to influence the actions of the European Union or a Member State. An affected Member State may seek the support of the European Commission to put an end to pressure exerted by a third country. While the ACR favors a diplomatic response and dialogue between the Commission and the third country, if dialogue fails and the coercive measures persist, the Regulation gives the Commission recourse to “countermeasures”. These include

- The introduction of new or increased customs duties, or any additional import or export tax on goods
- The introduction or increase of restrictions on the import or export of goods (notably by means of quotas or import/export licenses), or restrictions on the payment for goods
- The introduction of specific restrictions on goods in transit
- The imposition of
  - Export restrictions on goods covered by the Union's export control regime
  - Measures affecting trade in services
  - Measures affecting foreign direct investment
  - Restrictions on the protection of intellectual property rights or their commercial exploitation in respect of right holders who are nationals of the third country concerned
  - Restrictions on banking and insurance transactions, access to EU capital markets and other financial services activities
  - Restrictions on registration and authorisation under EU legislation of chemicals, healthcare items and plants
  - Restrictions on access to Union-funded research programs, or exclusion from Union-funded research programs.

In the context of public procurement procedures, the countermeasures also include

- The exclusion of products, services, or suppliers of goods or services from the third country concerned
- The exclusion of tenders with a total value exceeding a specified percentage of products or services from the third country concerned
- The introduction of a mandatory penalty weighting when evaluating tender prices.

> **“The Regulation gives the Commission recourse to “countermeasures”.**

SCREENING INBOUND AND OUTBOUND FOREIGN INVESTMENT

By the end of 2023, almost all EU Member States will have a foreign investment control mechanism in place to prevent the leakage of sensitive technologies and know-how. Even Member States that are keen to keep their economies open, such as the Netherlands, Ireland and Malta, have adopted control mechanisms.

In October 2023, the Commission published its annual report on the screening of foreign investments, which made the following points.

The main countries of residence for inbound investors in 2022 were the United States, the United Kingdom, China, Japan, the Cayman Islands and Canada.

Of the more than 420 files examined in 2022, 87% of files were assessed in just 15 days and less than 3% resulted in an opinion by the Commission, avoiding any delay in the granting of authorisations by Member States. Most of the cases concerned the energy, aerospace, defense, semiconductors, healthcare, data processing and storage, communications, transport and cybersecurity industries.

EU Member States blocked 560 applications for the export of dual-use goods over the same period. The Commission believes this demonstrates the clear commitment by the Commission and Member States to safeguarding European security and public order.

The Commission concluded, however, that investment control was not enough, and that outbound investment control should now be introduced for the most sensitive fields and technologies, such as microelectronics, quantum computing, robotics, artificial intelligence, biotechnology, dual-use goods and activities that could lead to human rights violations. The development and implementation of this filtering framework should be coordinated between the European Union and the United States.

The adoption of this new instrument on outbound investment is likely to give rise to lively debate between Member States, even though foreign investment policies are essentially their own responsibility.

In its 3 October recommendation, the Commission called for an in-depth discussion on the need to take precise and proportionate measures to promote or protect certain areas of technology. The Commission examined 10 critical areas and targeted the following four as particularly sensitive:

- Advanced semiconductor technologies, such as microelectronics, photonics, high-frequency chips and semiconductor manufacturing equipment
- Artificial intelligence, including high-performance computing, cloud and edge computing, data analysis, computer vision, language processing and object recognition
- Quantum technologies, including computing, cryptography, communications, and detection and radar
- Biotechnologies, such as genetic modification techniques, new genomic techniques, genetic forcing, and synthetic biology, which can be diverted or used as precursors in, for example, agriculture, the environment, health, or the production of biological products. Some biotechnologies, such as genetic engineering applied to pathogens or harmful compounds derived from the genetic modification of micro-organisms, can have a security/military dimension, particularly when misused.

A group of experts from the Member States will be set up to assist the Commission, which will also consult companies and other stakeholders, and even partner countries, to determine possible measures to respond to the identified risks.

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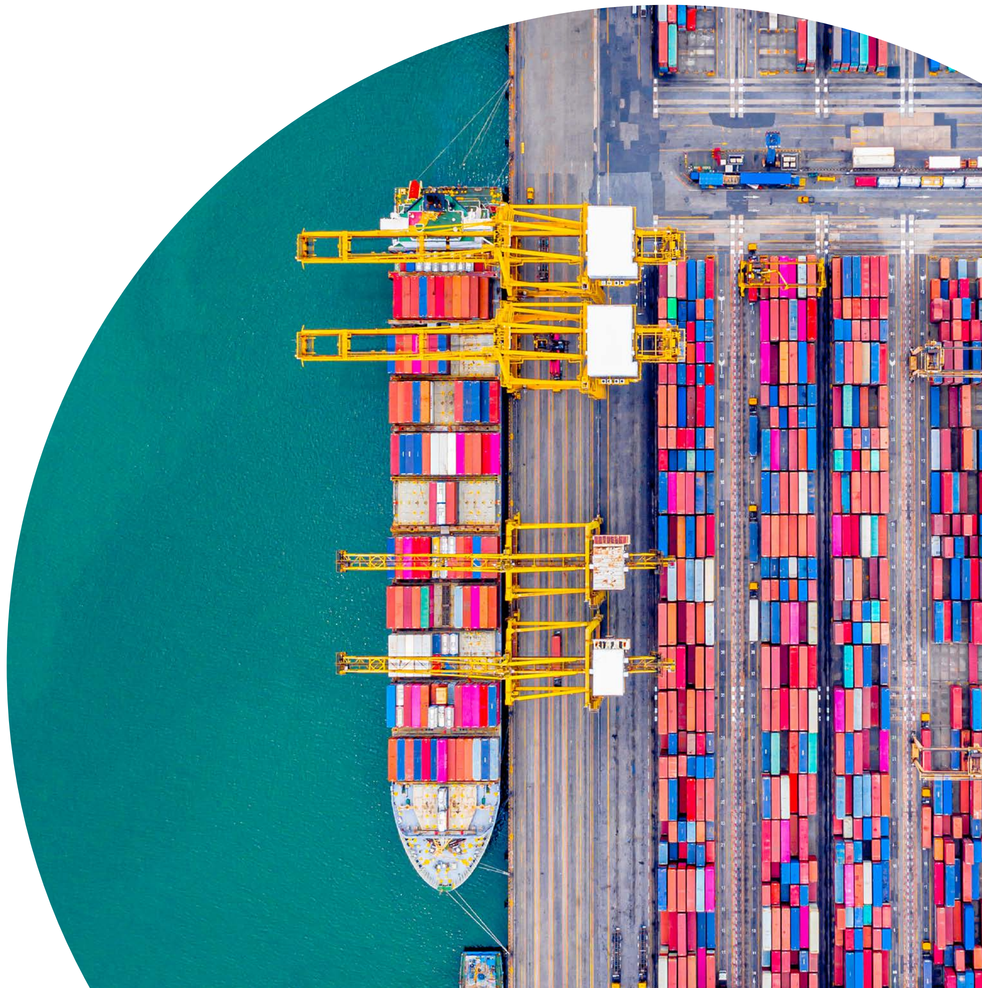

THE IMPACT OF THE NEW EU FOREIGN SUBSIDIES REGULATION

Hendrik Viaene and Stéphane Dionnet

EU Regulation 2022/2560 on Foreign Subsidies Distorting the Internal Market (FSR) came into force on July 12, 2023, with notification obligations taking effect on October 12, 2023. This marks a transformative moment for companies operating within the European Union.

WHAT CONSTITUTES A FOREIGN SUBSIDY

The FSR applies to any company doing business in the European Union. It will be considered to have received a "foreign subsidy" if the following four criteria are satisfied:

1. A financial contribution (such as interest-free loans, unrestricted guarantees, capital injections, preferential tax treatment, tax credits, or grants) is awarded to support the activities of a business entity.
2. The financial contribution is supplied either directly or indirectly by a third country from outside the European Union.
3. The contribution results in a discernible advantage being conferred upon the business entity.
4. This advantage is selective.

M&A TRANSACTIONS AND PUBLIC PROCUREMENT CONTRACTS

Understanding and defining the scope of the FSR as it applies to a transaction or deal is an essential step to ensure compliance and manage potential risks effectively. Non-compliance can result in significant penalties. The European Commission can impose fines of up to 10% of the turnover of the undertaking concerned, typically encompassing the entire group's worldwide financial performance in the previous fiscal year.

Transaction Timing

Transactions that were signed, or public procurement procedures that were initiated after 12 July 2023, are subject to FSR notification and investigation.

Reporting Obligations

The European Commission has been granted the power to investigate foreign financial contributions (FFCs) granted by non-EU governments to companies active in the European Union. If the Commission finds that an FFC is a foreign subsidy that creates a distortion of the EU internal market, it can impose measures to redress their distortive effects.

In the context of an M&A deal, companies are obliged to submit a notification in advance if the combined FFCs of all the companies involved in the deal (target included) exceeds €50 million in the three years prior to notification and one of the following applies:

- The transaction qualifies as a "concentration" under the EU Merger Regulation *i.e.*, it involves a change of control on a lasting basis.
- The EU-wide turnover of the target, one of the merging parties, or the joint venture itself, is at least €500 million in the previous financial year.

Parties meeting or exceeding these thresholds must notify the European Commission of FFCs received from non-EU public authorities.

> **"Non-compliance can result in significant penalties.**

Even if a transaction does not meet the notification thresholds, the Commission can call in the transaction before it is closed, after which the transaction will be treated as a notified transaction with a stand-still obligation on the parties.

In the context of a public procurement tender, companies are obliged to submit a notification in advance if the combined FFCs of the bidding party exceed €4 million in the three years prior to the FSR notification and one of the following criteria are met:

- The tender relates to an EU Member State public contract for works, supply of products, provision of services, or concessions; excluding contracts in defense/security, urgency contracts without prior call, and contracts that can only be supplied by a particular entity.
- The contract value is €250 million or over and, in cases where the tender is divided into lots, the aggregate value of the lots applied for is €125 million or over.

Timeline For Notifications

In line with the practices of merger control, the European Commission places significant emphasis on the value of voluntary pre-notification discussions for M&A transactions and public procurement contracts.

The official timeline for the notification-based procedures begins when the Commission has received a notification containing all required information and declares the notification complete. The Commission

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then conducts an initial assessment to ascertain whether or not the FFCs 1) qualify as a foreign subsidy and 2) have the potential to disrupt the market.

If concerns about market distortion arise, the Commission will launch an in-depth investigation. Unlike in merger control, however, the FSR does not allow Phase 1 conditional clearances; remedies can only be offered in Phase 2.

For M&A deals, the investigation must begin within 25 working days of receiving the complete notification and can last up to 90 working days, with a possible extension of 15 working days.

In relation to public procurement contracts, the European Commission has 20 working days for the initial assessment and is required to issue a final decision within 110 working days, which includes the preliminary review phase.

Substantive assessment

The FSR establishes two legal presumptions to establish whether or not the subsidies cause distortion:

1. Subsidies are considered likely to be distortive if they meet one of the following criteria: support a failing business, are unlimited, facilitate a concentration, do not comply with the Organisation for Economic Co-operation and Development Arrangement on officially supported export credits, or enable a company to submit an unduly advantageous tender.
2. Subsidies unlikely to be considered distortive if they totaled less than €4 million in the previous three years or were intended to restore a business after damage caused by natural disasters or exceptional circumstances.

> “ The FSR has also introduced an *ex officio* procedure.

In the event that the European Commission determines the existence of a foreign subsidy that induces market distortion, it will balance the negative effects of the subsidy against its positive effects to determine appropriate redressive measures or to accept commitments from the notifying party. The criteria employed for the appraisal of distortion include the size of the subsidy; the characteristics of the entities involved, including their dimensions, market presence, and sectors; their economic activities within the internal market; the intent and stipulations of the subsidy; and its manner of use.

For M&A transactions, the FSR provides a non-exhaustive list of potential remedies or redressive measures, both structural and non-structural, which may include divestment of certain assets or granting access to infrastructure. The list is broader than typical divestiture or access-type behavioural commitments in merger control. Ultimately, the European can approve, block, or conditionally approve the transaction, subject to redressive measures or commitments offered by the notifying party/parties.

Form and Submission of Notifications

Notifying parties involved in M&A deals must use Form FS-CO to submit details of the deal to the Commission's Directorate-General in charge of competition.

Parties involved in public procurement contracts must complete and submit Form FS-PP to the contracting authority which, in turn, will forward the notification to the Commission's Directorate-General in charge of the internal market.

For both M&A transactions and EU public tenders, the forms require general information, such as an executive summary of the deal or tender, (e.g., the transaction financing and valuation, or a detailed description of the bidding process and other bidders, if applicable); details about the involved parties, information regarding FFCs received in the past three years, and relevant supporting documentation.

EX OFFICIO INVESTIGATIONS

The FSR has also introduced an *ex officio* procedure to investigate alleged distortions of the internal market. This procedure is not limited to public procurement or M&A transactions

The Commission may launch an *ex officio* investigation if it suspects that foreign subsidies may have been granted in the last 10 years, as long as these fell after 12 July 2018, *i.e.*, five years before the FSR came into force on 12 July 2023. The FSR does not, however, apply where other legislation already covers the potential subsidies. One example is the EU Anti-Subsidy Regulation 2016/1037, which addresses potential distortive foreign subsidies relating to goods imported into the European Union.

All enterprises that are engaged in business within the European Union and are aware of having received subsidies from non-EU sources, are well advised to compile records of all such contributions dating back to 12 July 2018.

NEXT STEPS

It is vital that companies are well prepared for the demands of the FSR. At the very minimum, all companies doing business in the European Union should take the following actions:

- Identify and gather details on historical FFCs.
- Prioritise the gathering of internal data on new FFCs on an ongoing basis.
- Determine whether or not a contemplated transaction or public tender meets the FSR threshold.
- Engage in pre-notification discussions when an FSR filing is required.
- Incorporate FSR requirement considerations into deal/tender documentation.

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