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Reconciling National Security Review with Takeover Regulation in the Global M&A Market

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Abstract

In recent times, there has been an unprecedented surge in national security review (NSR) measures, with host jurisdictions implementing restrictions on foreign investments and intensifying national security scrutiny, especially in the context of cross-border takeover transactions within sensitive sectors. This paper argues that this evolving landscape disrupts conventional takeover regulation in a manner that impedes the operation of the global takeover market. To substantiate this assertion, the paper leans on four paradigms: (1) interest paradigm; (ii) decision paradigm; (iii) information paradigm; and (iv) accountability paradigm. The crux of our policy proposal is to broaden the purview of takeover regulation to encompass national interest considerations. Adopting such a reconciliatory approach would ensure that cross-border takeover transactions are not stymied by the somewhat erratic and whimsical implementation of NSR measures, while preserving the integrity of the rule-based global takeover market without compromising legitimate national security concerns.

Keywords: National security review, cross-border takeover, takeover regulation, board compliance, Covid-19 pandemic

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ABSTRACT

In recent times, there has been an unprecedented surge in national security review (NSR) measures, with host jurisdictions implementing restrictions on foreign investments and intensifying national security scrutiny, especially in the context of cross-border takeover transactions within sensitive sectors. This paper argues that this evolving landscape disrupts conventional takeover regulation in a manner that impedes the operation of the global takeover market. To substantiate this assertion, the paper leans on four paradigms: (1) interest paradigm; (ii) decision paradigm; (iii) information paradigm; and (iv) accountability paradigm. The crux of our policy proposal is to broaden the purview of takeover regulation to encompass national interest considerations. Adopting such a reconciliatory approach would ensure that cross-border takeover transactions are not stymied by the somewhat erratic and whimsical implementation of NSR measures, while preserving the integrity of the rule-based global takeover market without compromising legitimate national security concerns.

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Introduction

Recent years have witnessed an unparalleled proliferation of national security review (NSR) measures, with host jurisdictions imposing stringent restrictions on foreign investments and intensifying national security scrutiny, especially on cross-border takeover deals in sensitive sectors. While such mechanisms are not new—evidenced by the establishment of the Committee on Foreign Investment in the US (CFIUS) in 1975[1] and Australia's Foreign Acquisitions and Takeovers Act 1975[2]—they were seldom utilized until the turn of the century, catalyzed by events such as the World Trade Center attacks and the global financial crisis,[3] and most recently as a response to economic uncertainties and the risk of 'predatory' takeovers arising from the Covid-19 pandemic and the rising geopolitical tensions.[4]

Such intensified utilization has broadened the scope of perceived threats subject to NSR mechanisms during cross-border takeovers to encompass wider economic interests.[5] On 3 October 2023, for instance, the European Commission adopted the *Recommendation on critical technology areas for the EU's economic security*, which identified 10 critical technology areas, including semiconductors and artificial intelligence, for a collective risk assessments.[6] Member States who have not yet implemented national screening mechanisms have been urged to do so without further delay.[7]

Given this context, this paper aims to scrutinize the repercussions of the swift expansion of NSR on the takeover market and its regulation.[8] The confluence of these domains is crucial,

[1] J. Russell Blakey, 'The Foreign Investment Risk Review Modernization Act: The Double-Edged Sword of U.S. Foreign Investment Regulations' (2020) 58 Loyola of Los Angeles Law Review 981, at 982.

[2] Vivienne Bath, 'Foreign Investment, the National Interest and National Security - Foreign Direct Investment in Australia and China' (2012) 34 Sydney Law Review 5, at 7.

[3] OECD, 'Acquisition- and ownership-related policies to safeguard essential security interests: Current and emerging trends, observed designs, and policy practice in 62 economies' (May 2020), at 12.

[4] Ibid, at 14.

[5] Ibid.

[6] European Commission, *COMMISSION RECOMMENDATION of 3.10.2023 on critical technology areas for the EU's economic security for further risk assessment with Member States*, Strasbourg, 3.10.2023 C(2023) 6689 final.

[7] See also European Commission, *Joint Communication on European Economic Security Strategy*, Brussels, 20.6.2023 JOIN(2023) 20 final.

[8] While there is a rich body of literature that analyses security screening mechanisms over foreign direct investment, much less has been said about the interplay between screening mechanisms and the takeover market. See, in general, Carlos Esplugues, *Foreign Investment, Strategic Assets and National Security* (Cambridge: Cambridge University Press, 2018); Felix I. Lessambo, *Mergers in the Global Markets: A Comparative Approach to the Competition and National Security Laws among the US, EU, and China* (Palgrave Macmillan 2020); also Kristen Eichensehr and Cathy Hwang, 'National Security Creep in Corporate Transactions' (2023) 123 Columbia Law Review 549; Jeffrey N. Gordon and Curtis J. Milhaupt, 'China as a "National Strategic Buyer": Towards a Multilateral Regime for Cross-Border M&A' (2019) 2019 Columbia Business Law Review 192; Christopher M.

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especially in the realm of cross-border takeovers involving listed companies.[9] In the past year of 2022, cross-border deals account for 32% of global M&A market volume ($3.6 trillion), consistent with the average proportion over the prior ten years (35%).[10]

We argue that the proliferation of NSR systems interacts with conventional takeover regulation in a way that obstructs the global takeover market and might result in a bifurcated regime for the latter. While domestic transactions remain under the purview of conventional takeover regulation, cross-border takeovers are additionally subjected to stringent screening regimes. This disparate system significantly alters the landscape for foreign acquirers in cross-border takeovers, maintaining regulatory *status quo* for domestic acquirers vying for the same target. For instance, in 2008, when Chinalco sought the Australian government's approval to increase its stake in Rio Tinto, the stringent conditions imposed, despite approval, favored BHP Billiton, another contender for the stake.[11] It is reported that BHP Billiton leveraged lobbying to secure its interests in acquiring control over the target against Chinalco.[12]

Expansive security screening mechanisms also directly influence the outcome of hostile takeover battles.[13] The target's management may invoke the screening mechanism to prevent an unwanted cross-border takeover, with the mechanism effectively operating as a form of defensive

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Tipler, 'Defining National Security: Resolving Ambiguity in the CFIUS Regulations' (2014) 35 University of Pennsylvania Journal of International Law 1223; Rebecca Mendelsohn and Allan Fels, 'Australia's foreign investment review board and the regulation of Chinese investment' (2014) 7 China Economic Journal 59; Paul Rose, 'FIRRMA and National Security' (Public Law and Legal Theory Working Paper Series No. 452, 2018), at https://ssrn.com/abstract=3235564 (last visited 15 November 2022); Megan Bowman, George Gilligan and Justin O'Brien, 'Foreign investment law and policy in Australia: a critical analysis' (2014) 8 Law and Financial Markets Review 65; Alec J. Berin, 'CFIUS or Sisyphus: Toward a European Framework for Foreign Direct Investment Review' (2019) 51 The George Washington International Law Review 701; Bas de Jong, Wolf Zwartkruis, 'The EU Regulation on Screening of Foreign Direct Investment: A Game Changer?' (2020) 31 European Business Law Review 447.

[9] While assessments on its impacts are largely inconclusive, the growth of cross-border takeover is driven by a combination of factors, including the integration of global economies, the liberalisation of trade and investment regimes, the growing participation of companies from emerging countries, the growth of stock markets, the abundance of capital flows, the discrepancy of tax schemes, and so on. Isil Erel, Rose C. Liao and Michael S. Weisbach, 'Determinants of Cross-Border Mergers and Acquisitions' (2012) 67 The Journal of Finance 1045 at 1077; also Bruno Lopes de Paula and Daiana Paula Pimenta, 'Effects of Cross-border Merger and Acquisition on the Operational Risk of US and Canadian Companies' (2020) 23 Global Business Review 1175.

[10] Lipton Wachtell, Rosen & Katz,, 'Cross-Border M&A – 2023 Checklist for Successful Acquisitions in the U.S.' (*Harvard Law School Forum on Corporate Governance* 7 January 2023) <https://corpgov.law.harvard.edu/2023/01/07/cross-border-ma-2023-checklist-for-successful-acquisitions-in-the-u-s/> accessed 10 October 2023

[11] David Hundt, 'The Changing Role of the FIRB and the Politics of Foreign Investment in Australia' (2020) 55 Australian Journal of Political Science 328, at 334-335.

[12] Mendelsohn and Fels, n 8 above, at 74; also Bath, n 2 above, at 18.

[13] Usually, transacting parties to a takeover include a condition precedent in the offer documentation by which the takeover cannot complete unless security clearances are in hand. Alternatively, the parties may seek to pre-clear security issues before even launching the offer. See also Baker McKenzie (2021) National Security and Investment Act to enter into full force on 4 January 2022. Baker McKenzie Blog (28 July). https://foreigninvestment.bakermckenzie.com/2021/07/28/national-security-and-investment-act-to-enter-into-full-force-on-4-january-2022-2/ (last visited 7 May 2022).

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measure.[14] On 6 November 2017, the then Singapore-based Broadcom made an $117 billion bid to acquire the shares of US-based Qualcomm, which is a major 5G chipset maker.[15] In defending the unsolicited offer, Qualcomm's board triggered a national security review by the CFIUS of the potentially largest tech takeover of all time.[16]

To mitigate the negative effects of the NSR mechanisms, this paper proposes broadening the scope of takeover regulation to incorporate national interest considerations in the decision-making processes of private actors like shareholders and directors. This would simultaneously necessitate a reduction in the stringency of the screening mechanisms, which appear to be exaggerated responses to market crises such as those induced by Covid-19. Adopting such a balanced approach would prevent takeover regulation from being overshadowed by screening mechanisms, allowing both regimes to coexist and maintain existing paradigms without necessitating a total overhaul.

The subsequent sections of this paper are organized as follows: Part II explores the rise of security screening regimes and their increasing adoption across various jurisdictions in recent years, a trend expedited by the repercussions of the Covid-19 pandemic. Part III delves into the ramifications of the phenomenon across the four regulatory dimensions of interests, decision-making, information, and accountability in the global takeover market. Part IV evaluates alternative strategies to reconcile the discrepancies between screening mechanisms and takeover regulation, and Part V offers concluding remarks.

I. Proliferation of National Security Screening Regimes

Conventional security review in cross-border takeover, which confers power on host governments to examine individual investment or acquisition proposals for their potential impact on national security, has hitherto been restricted to foreign acquisition of companies in sensitive sectors in a rather small number of jurisdictions.[17] Commencing around 2017 and later accelerated by the

[14] Amy Deen Westbrook, 'Securing the Nation or Entrenching the Board? The Evolution of CFIUS Review of Corporate Acquisitions' (2019) 102 Marquette Law Review 643, at 649.
[15] Ibid, at 651.
[16] Benjamin Waters, 'How to Avoid Hostile Takeovers Without Really Trying: The Broadcom-Qualcomm Saga' (*Georgetown Law Technology Review: Legal Impressions,* April 2018) <https://georgetownlawtechreview.org/how-to-avoid-hostile-takeovers-without-really-trying-the-broadcom-qualcomm-saga/GLTR-04-2018/> accessed 1 May 2023.
[17] OECD, *OECD Policy Responses to Coronavirus (COVID-19): Investment screening in times of COVID-19 and beyond*, 2020) 2 at https://www.oecd.org/coronavirus/policy-responses/investment-screening-in-times-of-covid-19-and-beyond-aa60af47/ (last visited 25 October 2021).

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Covid-19 pandemic, however, a new trend has emerged in the global takeover market, whereby a growing number of policymakers has resorted to the proliferation of security screening mechanisms to protect domestic industries and companies from foreign acquisitions.

Quantitatively, security screening mechanisms have expanded into an increasing number of jurisdictions, wherein comprehensive systems had largely been absent, with examples including the UK and the EU.[18] Qualitatively, security screening mechanisms have burgeoned into a wider scope of industry sectors, wherein such mechanisms had previously been inapplicable.[19] Such a proliferation of security screening mechanisms has significantly transformed the dynamics of the global takeover market.[20] What are the primary factors driving such a dynamic change? While the Covid-19 pandemic functions as the accelerator, the elephant in the room has largely been the impact of Chinese investments on host jurisdictions, especially in the western markets.[21]

A. Quantitative proliferation

Security screening mechanisms are not necessarily of recent vintage. A prime example is the CFIUS,[22] which is a committee comprising several agencies of the government and possesses the authority to review certain transactions involving foreign investment into the US. It is empowered to assess the impact of foreign investments on the national security of the US, and to protect national security of the US from foreign threats.[23]

Similarly, Australia has a relatively longstanding tradition of erecting comprehensive security screening mechanisms. Under the *Foreign Acquisitions and Takeovers Act 1975*,[24] foreign investors must notify the Treasurer of their proposed foreign investments that meet certain criteria.[25] Pursuant to this, the Treasurer has the power to prohibit these investments, or impose conditions on the way they are made, all with a view to ensuring the investments will not pose a

[18] 'Quantitative' proliferation of security screening mechanisms refers to the phenomenon by which a growing number of jurisdictions that had no, or very limited, screening arrangements, introduced restrictions in the recent past.
[19] 'Qualitative' proliferation refers to the expansion of the scope of security screening mechanisms by jurisdictions that already had restrictions.
[20] OECD, 'Acquisition- and ownership-related policies to safeguard essential security interests', n 3 above, at 12.
[21] See Gordon and Milhaupt, n 8 above.
[22] Blakey, n 1 above, at 982.
[23] It operates pursuant to section 721 of the Defense Production Act of 1950 as implemented by the Executive Order 11858, and the regulations at chapter VIII of title 31 of the Code of Federal Regulations.
[24] Accompanying this statute are the *Foreign Acquisitions and Takeovers Fees Impositions Act 2015* and its associated regulations.
[25] See Bath, n 2 above, at 7.

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threat to national interest or national security.[26] In making such decisions, the Treasurer has the benefit of the advice of the Foreign Investment Review Board (FIRB).[27] In contrast to the powerful CFIUS, however, the FIRB is a non-statutory advisory body. This is because the ultimate responsibility for deciding the fate of investments remains with the Treasurer.[28]

Apart from such standout examples, it is only around 2017 that security screening mechanisms began expanding to many more jurisdictions. This process was immediately thereafter accelerated in 2020 by the economic uncertainties and the stock price plunges generated by the Covid-19 pandemic.[29] The UK market had previously witnessed no standalone regime regarding security screening of foreign investment.[30] Public interest considerations were assessed as part of the merger control regime within the purview of the UK Competition and Markets Authority, except for investments in the defence sector.[31] As a direct fallout from Covid-19, however, the Enterprise Act 2002 was amended to empower the government to intervene in cross-border acquisitions on grounds of national security, especially where there was a need to respond to public health emergencies.[32]

Further, significant legislative reform has occurred with the enactment of the National Security and Investment Act (NSIA) 2021. Under this legislation, the government can issue orders in relation to national security risks emanating from acquisitions by foreigners of certain types of entities and assets in the UK. The legislative design requires an acquirer to make a mandatory notification and obtain approval for acquisitions of shares when they cross the limits of 25 per cent, 50 per cent, and 75 per cent in entities that operate in a list of sensitive sectors.[33] With such a broad jurisdictional scope, this legislation has overhauled the national security review of investments in the UK.[34]

As predidcted by the Government's Impact Assessment, the newly proposed regime could lead to approximately 1,000 to 1,830 notifications annually. This projection is particularly striking

[26] Hundt, n 11 above, 335; Bowman, Gilligan and O'Brien, n 8 above, at 66.
[27] Mendelsohn and Fels, n 8 above, at 61.
[28] Bowman, Gilligan and O'Brien, n 8 above, at 68-69.
[29] Figure 1 in OECD, 'OECD Policy Responses to Coronavirus (Covid-19)', n 17 above.
[30] Nicole Kar, Mark Daniel and Sofia Platzer, 'CFIUK? UK introduces National Security and Investment Bill' *Linklaters* (11 November 2020) at https://www.linklaters.com/en/insights/publications/2020/november/cfiuk-uk-introduces-national-security-and-investment-bill (last visited 14 March 2022).
[31] Brian Sher, et al, 'New mandatory UK FDI regime to control foreign investment' *CMS* (12 November 2020) at https://www.cms-lawnow.com/ealerts/2020/11/new-mandatory-uk-fdi-regime-to-control-foreign-investment (last visited 13 November 2021).
[32] Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2020.
[33] National Security and Investment Act 2021, s 8.
[34] The Act has become effective as of 4 January 2022.

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when contrasted with the fact that, since the implementation of the Enterprise Act 2002, only 12 transactions have been scrutinized under national security considerations. In a practical application of this authority, the NSIA was invoked for the first time in July 2022.[35] This inaugural instance involved the prohibition of Beijing Infinite Vision Technology Co. Ltd.'s attempt to acquire advanced vision-sensing technology from the University of Manchester, citing national security concerns.[36]

The tenet of non-interventionism in the takeover market was also characteristic in the EU's openness to foreign investment in general. For long, there had been neither harmonised legislation at the EU level for security screening nor a competent centralised body like CFIUS in the US.[37] As prescribed in the Treaty on the Functioning of the European Union (TFEU), 'all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited'.[38] Member States are allowed, based on their sovereignty and autonomy,[39] to take restrictive measures which are justifiable 'on grounds of public policy or public security'.[40]

Regulation (EU) 2019/452 has, however, established a framework for the screening of foreign direct investments into the European Union on the grounds of security or public order. It also introduces a mechanism for cooperation between member states on such matters.[41] Accordingly, the EU framework now allows the European Commission to issue opinions, albeit non-binding, 'when an investment poses a threat to the security or public order of more than one Member State, or when an investment could undermine a strategic project or programme of interest to the whole of EU'.[42] Further guidance on how to implement the screening mechanism was issued on 25 March 2020 for member states keeping in view the economic turmoil emanating from the Covid-19

[35] Kar, Daniel and Platzer, n 30 above. See also, Impact Assessment (IA) of the National Security and Investment Bill 2020, IA No: BEIS006(F)-20-CCP, 09/11/2020.

[36] Department for Business, Energy & Industrial Strategy, *Decision: Acquisition of know-how related to SCAMP-5 and SCAMP-7 vision sensing technology: notices of final order and variation of final order* (20 July 2022).

See also: Tim Castorina, Tara Rudra and Mark Daniel, 'First deal blocked under UK's NSIA' (*Linklaters,* 21 July 2022) <https://www.linklaters.com/nl-nl/insights/blogs/foreigninvestmentlinks/2022/july/first-deal-blocked-under-uks-nsia> accessed 10 October 2023

[37] 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, *OJ L 79I , 21.3.2019*, recital (5).

[38] Articles 63(1) & 65(1)(b), TFEU.

[39] A small number of member states had a screening system in place to instil such restrictive measures. As of February 2019, about 14 EU Member States had national investment screening mechanisms, including Austria, Denmark, Finland, France, Germany, Italy, the Netherlands and Spain. European Commission, 'Foreign Direct Investment: EU Screening Framework' (February 2019). https://trade.ec.europa.eu/doclib/docs/2019/february/tradoc_157683.pdf (last visited 28 April 2022).

[40] Articles 65(1)(b), TFEU.

[41] Regulation (EU) 2019/452, n 37 above, at 1–14.

[42] European Commission, 'EU foreign investment screening mechanism becomes fully operational' (9 October 2020) at https://trade.ec.europa.eu/doclib/press/index.cfm?id=2187 (last visited 15 March 2022).

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pandemic.[43] The objective of the guidance is to protect EU's strategic assets in critical healthcare infrastructure and on volatility and undervaluation of European companies that could result in a divestment of critical infrastructure and technologies.[44]

B. Qualitative expansion

Historically, security screening mechanisms have focused on specific sectors of the economy, such as the defence industry, critical domestic infrastructures and other sensitive sectors.[45] This relatively narrow scope, however, has been significantly expanded lately. Governments have turned their attention towards more novel threats to national security.

Take CFIUS for instance. Conventionally, a CFIUS review was triggered only by foreign acquisitions of control of US entities handling critical infrastructure. Under the Trump administration in 2018, the scope of activities subject to the CFIUS regime was expanded upon the passage of the Foreign Investment Risk Review Modernization Act (FIRRMA). Consequently, the ambit of CFIUS review has been extended from covering only controlling investments to include non-controlling investments as well.[46] Moreover, the 'review reaches acquisitions of control or investments giving access to critical technology, critical infrastructure or sensitive personal data; or where the investment gives a foreign person access to information about or involvement in decision making of a U.S. business.'[47]

The qualitative expansion of CFIUS scrutiny has been most notably evident in several takeover transactions involving Chinese investors. For instance, in May 2019, CFIUS invoked the retrospective veto power, compelling Beijing Kunlun Tech Co Ltd, a Chinese mobile gaming enterprise, to divest its ownership of Grindr LLC, a widely used gay dating application, which Kunlun had acquired in 2016.[48] CFIUS alleged that the application's Chinese ownership could

[43] 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 (FDI Screening Regulation), C(2020) 1981 final (hereinafter 'EU Guidance').
[44] European Commission, "Introductory statement by Commissioner Phil Hogan at Informal meeting of EU Trade Ministers" (16 April 2020).
[45] United Nations Conference on Trade and Development, *World Investment Report 2016: Investor Nationality: Policy Challenges* (2016) 94 at https://unctad.org/system/files/official-document/wir2016_en.pdf (last visited 15 November 2022), at 111-112.
[46] Blakey, n 1 above, at 999.
[47] Curtis J. Milhaupt & Michael Callahan, The Rule of Law in the U.S.-China Tech War, Available at SSRN: https://ssrn.com/abstract=3840584 (10 May 2021), at 7.
[48] Yuan Yang and James Fontanella-Khan, 'Grindr sold by Chinese owner after US national security concerns' *Financial Times* (7 March 2020) at https://www.ft.com/content/a32a740a-5fb3-11ea-8033-fa40a0d65a98 (last visited 7 March 2022).

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potentially expose US citizens to blackmail by Beijing, particularly regarding their "sexual orientation or HIV status",[49] in light of Grindr's collection of personal data from its myriad users.[50] Kunlun resorted to ensuring the secure local storage of the US data, ceasing its operations in China and keeping its headquarters in the US, all of which ultimately proved futile.[51]

Notably, the US has not tightened its screening mechanisms for acquisitions of US companies in response to the COVID-19 crisis, largely because the FIRRMA had been enacted shortly before the pandemic struck. However, the FIRMMA has been utilized aggressively to protect key industries affected by Covid-19. For example, on 9 April 2020, a cohort of 18 senators led by the then Chairman of the Senate Armed Services Committee, Jim Inhofe (R-Okla.), sent a letter to the then President Trump urging the aggressive use of CFIUS authorities, strengthened by FIRRMA, to scrutinize investments 'that could threaten or undermine the national security of the [US] including any transactions involving nascent technological capabilities with likely national security applications.'[52]

For several other jurisdictions, the extraordinary economic circumstances triggered by the Covid-19 pandemic have accelerated the expansion of scope of security screening. It has been a perennial concern that extraordinary economic circumstances, such as the Asian financial crises in 1998 or the global financial crisis in 2008, could generate a 'fire-sale' of undervalued assets.[53] Such connection between distressed domestic firms and potential foreign acquirers has also been made promptly at the start of the Covid-19 pandemic. Among others, Fabry and Bertolini warned in April 2020 that '[t]he weakening position of European companies will create many opportunities for corporate takeovers at bargain prices.'[54]

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[49] Carl O'Donnell, Liana B. Baker and Echo Wang, 'Exclusive: Told U.S. security at risk, Chinese firm seeks to sell Grindr dating app' (*Reuters,* 28 March 2019) <https://www.reuters.com/article/us-grindr-m-a-exclusive/exclusive-us-pushes-chinese-owner-of-grindr-to-divest-the-dating-app-sources-idUSKCN1R809L/> accessed 1 September 2023

[50] At Grindr, "Personal Data" means any information that allows users to be identified directly. Grindr starts to collect personal data as soon as a user starts interacting with the Grindr Services on the web, by downloading the app, liking the app on social media, or making a contact with them directly. Privacy Policy of Grindr, https://www.grindr.com/privacy-policy/personal-data-collected/?lang=en-US (last visited 28 January 2023).

[51] See also David Myles, 'Grindr? it's a "Blackmailer's goldmine"! The weaponization of queer data publics Amid the US–China trade conflict' (2022) 25 Sexualities 1. (This paper … highlight how the politicization of queer vulnerabilities amid global hegemonic conflicts is a tactic that predates the US-China trade conflict.)

[52] Letter of the United States Senate to the President, 9 April 2020, at https://www.inhofe.senate.gov/imo/media/doc/04-08-20%20Protecting%20Defense%20Industrial%20Base%20COVID%20Letter%20-%20FINAL.pdf.

[53] See, for example, Paul Krugman 'Fire-Sale FDI' in S. Edwards (ed.) *Capital Flows and the Emerging Economies: Theory, Evidence, and Controversies* (University of Chicago Press for NBER, 2000) at https://www.nber.org/system/files/chapters/c6164/c6164.pdf (last visited 14 March 2022).

[54] E. Fabry and N. Bertolini 'COVID-19: The Urgent Need for Stricter Foreign Investment Controls' (Notre Europe, Jacques Delors Institute. Policy Paper No. 253. April 2020) P1 at https://institutdelors.eu/wp-content/uploads/2020/10/PP253_FDIscreening_Fabry_200427_EN.pdf (last visited 14 March 2022). See also, EU Guidance, n 43 above.

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A dedicated OECD Report, entitled Investment Screening in Times of COVID-19, classifies the expansion of the scope of security screening into two main categories:

(a) Pandemic-related industries, wherein the scope of screening is expanded to cover industries 'that are crucial for the pandemic response', such as 'health-related industry sectors and associated supply chains'; and

(b) Pandemic-impacted entities, wherein the scope of screening is expanded to cover 'acquisitions in *any* sector where target entities suffer from temporary financial stress and value distortions under the exceptional economic conditions associated with the pandemic.'[55]

The OECD Report goes on to note that screening mechanisms had hitherto not particularly focused on the healthcare sector given the absence of any pandemic in recent decades. The exposure of the vulnerability of the sector has led regulators to expand the scope of screening mechanism to include public health sector.[56] Consequently, these sensitive sectors were incorporated into the review lists for which tighter screening mechanisms apply.[57] For instance, the '[a]cquisitions of biotechnologies or medical devices companies are also now or will very soon be subject to investment screening in 20 OECD countries that screen inward FDI for security reasons, up from 11 countries prior to the pandemic'.[58]

Furthermore, since countries faced economic disruptions in the wake of the pandemic, governments expanded the scope of screening mechanisms to cover additional sectors even when targets only suffered temporary reductions in stock price and valuations.[59] Such an expansion usually extended to sectors that are well beyond the sectors such as healthcare that were more immediately affected by the pandemic.[60] Among jurisdictions that have taken such measures, Australia reformed its foreign investment review framework to significantly expand the scope of security screening. The revised national security test requirement, among other things, temporarily reduced the monetary screening threshold to govern foreign acquisitions of any value, i.e., zero dollar monetary threshold, in business or land affected by national security concerns.[61]

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[55] OECD, 'OECD Policy Responses to Coronavirus (Covid-19)', n 17 above, at 4 (emphasis in original).
[56] Ibid.
[57] Ibid.
[58] Ibid, at 5.
[59] Ibid.
[60] Ibid.
[61] 'Foreign Investment Review Board, Guidance 8 – National Security Test', Foreign Investment Review Board, 17 December 2020.

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A similar approach is observable in France, where the trigger threshold for the security review mechanism has been lowered from 25 per cent to a 10 per cent foreign shareholding in listed companies.[62] The French government has also avowed to fight foreign investments that threaten the domestic industry, such that 'whether in the aeronautics, automotive or health sectors, it is essential to be able to protect companies whose value is now collapsing and which are becoming easy prey for foreign investors.'[63] Consequently, in January 2021, France's Economy Minister Bruno Le Maire stopped Canada's Alimentation Couche-Tard from taking over French retail giant Carrefour on the basis of 'food security'.[64] These instances indicate that the scope of the security screening mechanisms has vastly expanded in recent years beyond matters of physical security into the realm of economic security as well.

C. Political economy determinants

The quantitative and qualitative development of NSR mechanisms has introduced a new dynamic into the global takeover market. Under the new normal of expanded screening mechanisms, the risk of an overbearing intervention by the governmental authority is likely a given, which would adversely affect the ability of the parties to complete the transaction in a timely manner. Moreover, 'governments have a greater degree of discretion under FDI regimes for making substantive interventions compared to other regulatory processes, as FDI regulatory reviews are more at risk of politicisation.'[65]

What are the primary factors driving such a dynamic change? While the Covid-19 pandemic has functioned as the accelerator, the main driver has largely been the spread of Chinese investment

[62] The measure, effective on 23 July 2020, is based on Décret n°2020-1729 du 28 décembre 2020 modifiant le décret n°2020-892 du 22 juillet 2020 relatif à l'abaissement temporaire du seuil de contrôle des investissements étrangers dans les sociétés françaises dont les actions sont admises aux négociations sur un marché réglementé, JORF No.0315, 30 December 2020. The measure, however, is applicable to non-EU, non-EEA investors only. Other jurisdictions expanding the scope of security screen include 'Hungary (lower and additional trigger thresholds apply temporarily), Italy (more exigent rules temporarily apply to EU and EEA investors) and New Zealand (transactions that are not normally reviewable are temporarily reviewable).' OECD, 'OECD Policy Responses to Coronavirus (Covid-19)', n 17 above, at 5.

[63] B. Le Maire, Declaration of 17 April before the French Government, Examen du 2ème projet de loi de finances rectificative pour 2020 (17 Apr 2020).

[64] Giorgio Leali, 'France shields Carrefour from takeover in food security battle' *Politico* (15 January 2021) at https://www.politico.eu/article/france-carrefour-takeover-food-security-battle/ (last visited 15 February 2022)

[65] Emily Xueref-Poviac, 'Foreign Direct Investment: An overview of the EU and national case law' (15 September 2021) e-Competitions Special Issue Foreign Direct Investment, N°101654

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around the world.[66] The concerns are more specifically attributable to China's 'variant of state capitalism',[67] which includes the state's influence over acquiring enterprises, the requirement that such enterprises share information with the state, and finally the overall ambition of China to attain technological superiority.[68] For example, despite the remarkably high volume of bilateral investment with China, Germany has blocked attempted acquisitions by Chinese buyers of advanced technology companies, e.g., Aixtron in 2016, Leifeld in 2018, and IMST GmbH in 2020.[69]

The concerns over Chinese buyers are further exacerbated by the economic transition to a data-driven economy and the growing geopolitical rivalry between China and the West. In particular, the US has displayed concerns about the 'rise of China as a technological power and, more specifically, about whether China is unfairly using investments in sensitive US technologies to facilitate that rise.'[70] As digital technologies, such as '5G, AI, biotech, robotics, space technologies, and other advanced components of 21st century economic and military advantage'[71] continue to develop, governments' concerns regarding the capabilities of the private sector to handle sensitive data will only exacerbate. Although both domestic and foreign acquirers are likely to pose apprehensions on these fronts, 'foreign firms perceived as having connections to foreign governments are likely to encounter the toughest questioning.'[72] Considerable evidence exists to suggest that China's technological advancement has acted as the catalyst factor for FIRRMA.[73]

In sum, the aforesaid analysis demonstrates the proliferation of security screening mechanisms deployed by host jurisdictions around the world through which governments restrict cross-border takeover deals targeting sensitive sectors and subject these deals to close scrutiny and approval requirements. This new trend has projected significant uncertainties and disruptions in the cross-

[66] These concerns over Chinese investments, however, have not been unchallenged. It has been suggested that concerns over large market distortions caused by Chinese investment are "overblown worries from an economic point of view". Marta Domínguez-Jiménez and Niclas Poitiers, 'Europe's China problem: investment screening and state aid' (*Bruegel Blog,* 2 July 2020), at https://www.bruegel.org/2020/07/europes-china-problem-investment-screening-and-state-aid. (last visited 1 November 2021).

[67] Simon J. Evenett, 'What Caused The Resurgence In FDI Screening?' (2021) SUERF Policy Note Issue No 240 12 at https://www.suerf.org/policynotes/24933/what-caused-the-resurgence-in-fdi-screening#:~:text=While%20the%20pandemic%20was%20an,greater%20resort%20to%20FDI%20screening. (last visited 14 March 2022).

[68] Milhaupt and Callahan, n 47 above, 10. Also, in general, N. Inkster, *The Great Decoupling: China, America, and the Struggle for Technological Supremacy* (London: Hurst Publishing, 2020)

[69] Cheng Bian, 'Foreign Direct Investment Screening and National Security: Reducing Regulatory Hurdles to Investors Through Induced Reciprocity' (2021) 22 Journal of World Investment & Trade 561, at 571-3.

[70] Rose, n 8 above, at 2.

[71] Milhaupt & Callahan, n 47 above, at 1.

[72] Evenett, n 67 above, at 11.

[73] Blakey, n 1 above, 995. See also US Treasury, Presidential Memorandum on the Actions by the United States Related to the Section 301 Investigation (22 March 2018), which laid out the case against China in four points.

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border takeover market. There is reason to suggest that the recent spate of measures are not necessarily temporary, and could take on a more long-lasting role, especially with more intensified focus on sensitive technology and data.[74] The failure of screening mechanisms to discern between risky acquisitions and benign ones can have far-fetched implications on cross-border takeover.[75] As the OECD notes:

> [The mechanisms] could for instance *discourage* some legitimate would-be acquirers from investment decisions; could *distort* the market for mergers and acquisitions in favour of investors that are subject to lesser or no review mechanisms; influence *valuations* of assets that are considered sensitive; or lead to secondary effects with regards to the global allocation of capital.[76]

II. Implications on Regulatory Paradigms of the Takeover Market

After examining how the security screening mechanisms have rapidly expanded both quantitatively and qualitatively to subsume the principal regulatory aspects of cross-border takeovers, the paper now delves into the implications of such developments on traditional takeover regulation and the market for cross-border takeovers. It approaches this from four paradigms: (i) interest paradigm; (ii) decision paradigm; (iii) information paradigm; and (iv) accountability paradigm. It is the refrain of this paper that, across all these paradigms, security screening mechanisms have substantially encroached upon the operational dynamics of the cross-border takeover market, thereby transforming the playing field for acquirers, targets, and their respective stakeholders.

[74] Herbert Smith Freehills, "Herbert Smith Freehills on foreign investment", *The In-House Lawyer* (Summer 2018) 25 at https://www.inhouselawyer.co.uk/legal-briefing/herbert-smith-freehills-on-foreign-investment/ (last visited 15 November 2021).
[75] OECD, 'Acquisition- and ownership-related policies to safeguard essential security interests', n 3 above, at 99.
[76] Ibid, at 100 [emphasis in original].

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A. Interest paradigm

Conventional takeover regulation primarily revolves around the interests of the company (whether the target or the acquirer),[77] its shareholders and other stakeholders such as employees, creditors, and consumers. These interests are rather finite in nature. While some jurisdictions embrace a more explicit stakeholder-orientation to include interests such as the environment and the community,[78] these broader interests are still gauged in the context of the specific target company. In essence, within traditional takeover regulation, the interest paradigm predominantly functions on a company-centric foundation.

However, when it comes to the security screening mechanisms, the yardsticks employed are vastly different. They relate either to 'national security' or 'national interest', which are country-specific or market-specific, and are not limited to the company involved in a cross-border takeover. Such considerations extend to all cross-border takeovers in a country or an industry.[79] The governmental authorities applying the security screening mechanisms are unconcerned about the impact of a cross-border takeover on specific stakeholders of the company, but rather on the country or economy as a whole. The interest paradigm in such a scenario is boundless. As Professor Westbrook notes in the context of CFIUS:

> Corporations are not merely matters of concern to shareholders, boards, and managers who contest governance, or even the broader society of stakeholders. Corporations are deeply enmeshed in the economy and society, and therefore the relationship between ownership and management has implications that extend beyond stakeholders.[80]

To that extent, the proliferation of screening mechanisms pushes the regulation of cross-border takeovers firmly into the domain of public law, with limited, if any, emphasis on the interests of specific private stakeholders involved in a company that is the subject matter of a control contest.

Moreover, the qualitative enlargement of screening mechanisms intensifies the 'public' nature of the regulatory review of takeovers. With the recent expansion of the understanding of national security and national interest to economic matters more generally, the encroachment of screening

[77] From a cross-border perspective, the interest-based analysis for the target company will have to be carried out under the laws of the jurisdiction where it is incorporated (or listed). A similar analysis will apply for the acquirer company in the jurisdiction where it is incorporated.
[78] See English Companies Act 2006, s 172; Indian Companies Act, 2013, s 166(2).
[79] M.R. Byrne, 'Protecting National Security and Promoting Foreign Investment: Maintaining the Exon-Florio Balance' (2006) 67 Ohio State Law Journal 849, at 904; Esplugues, n 8 above, at 278.
[80] Westbrook, n 14 above, at 698.

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mechanisms into takeover regulation is overbearing. For instance, the fate of a takeover may be determined based on whether it affects the economy as a whole, or domestic interests in a particular industry, thereby leading to concerns regarding economic protectionism.

Given that the themes of national security and national interests are dynamic in nature, they are only likely to expand even further, thereby diminishing any gap between conventional takeover regulation, which is company-specific and transaction-specific, and security screening mechanisms, which are nation-specific and market-specific (and instead agnostic to the interests of specific companies or their stakeholders). By focusing on broader economic issues and outcomes, such a generalised assessment of cross-border takeovers will likely ensnare a wide array of such transactions in a given jurisdiction. Its inability to discern value-enhancing transactions from value-reducing transactions from the perspective of shareholders and stakeholders of the target company on an individual basis weakens the market for corporate control as an effective corporate governance mechanism.

B. Decision paradigm

This leads to the question as to who holds the power to determine the success (or failure) of a takeover in a cross-border scenario. Under conventional takeover regulation, considerable deference is rendered to the decision-making powers of the shareholders or board of directors of the target company. In the UK and other jurisdictions that subscribe to the board neutrality rule, the shareholders retain the opportunity to decide on the merits of a takeover offer.[81] Through its actions, the board of the target company cannot deprive the shareholders of their decision-making powers. Although boards in the US have enjoyed greater autonomy in determining the fate of a takeover offer, their actions have been subject to strict scrutiny by the courts in light of directors' duties under state corporate law.[82] Hence, under conventional regulation, proponents and opponents of a takeover are locked in a battle to appeal to the sensibilities of the private actors (such as directors or shareholders) and to seek their approval in favour of, or against, the transaction.

[81] UK Takeover Code, GP 3; The Singapore Code on Take-overs and Mergers, GP 6; The Codes on Takeovers and Mergers and Share Buy-backs (Hong Kong), GP 9.

[82] However, for the recent deference by Delaware courts to decision-making by an independent board of the target and a disinterested vote of the target's shareholders. Zohar Goshen and Sharon Hannes, 'The Death of Corporate Law' (2019) 94 New York University Law Review 263

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In all these circumstances, neither a regulatory body such as the takeover panel nor a court of law has the ability or the inclination to subvert the decisions of the private actors such as the board or the shareholders on the merits of a transaction.[83] Their role is essentially to ensure that the decision-making process by the private actors is carried out in a fair and transparent manner in accordance with the principles of conventional takeover regulation. Such an approach is 'market-centric' in nature.[84]

Conversely, under the security screening mechanism, the determination of whether a cross-border takeover can proceed is entirely in the hands of the relevant governmental authority vested with oversight powers. Such powers are shared by the legislators who enact security screening laws, and the executive who promulgates consequential rules and implements the legal regime on a case-by-case basis.[85] Given that the governmental authorities are concerned with matters of national security and national interest, they bear no obligation to consider the wishes of the board or shareholders of the target company, which the authorities can very well disregard altogether.

The exclusivity enjoyed by the government regulators in decision-making in a cross-border takeover spawns rent-seeking concerns. For instance, proponents and opponents of a transaction may be motivated to engage in frenetic lobbying to buttress their point of view and orchestrate an outcome that is favourable to them.[86] They need only to appeal to the sensibilities of the public officials rather than to the entire board of the target or, even more, to masses of shareholders. This is not to suggest that government authorities overseeing national security or national interest matters are monolithic in nature.

For example, in the US, the President is under no obligation to adopt the recommendation of the CFIUS as to the prohibition or suspension of a transaction.[87] Similarly, in Australia, the functions of the FIRB are advisory, and the ultimate decision-making power regarding foreign investment proposals vests with the Treasurer.[88] Nevertheless, those actors interested in the outcome of a cross-border takeover may find it efficient to steer decision-making through the governmental regulatory process as opposed to the corporate machinery involving shareholders

[83] David Kershaw, *Principles of Takeover Regulation* (Oxford University Press 2016), at 120.
[84] Goshen and Hannes, n 82 above, at 286.
[85] OECD, 'Acquisition- and ownership-related policies to safeguard essential security interests', n 3 above, at 43.
[86] For examples of such lobbying, see Westbrook, n 14 above.
[87] Congressional Research Services, *The Committee on Foreign Investment in the United States (CFIUS)* (February 14, 2020) 21.
[88] Foreign Investment Review Board, *About FIRB* at https://firb.gov.au/about-firb (last visited 25 November 2021).

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and directors. In any event, the governmental decision-making process raises complexities due to its utmost furtiveness, to which the paper now turns.

C. Information paradigm

Conventional regulation of the market for corporate control is steeped in the principle of transparency. General Principle 2 of the UK Takeover Code provides that the target's shareholders must receive sufficient information 'to enable them to reach a properly informed decision on the takeover bid', which includes 'the merits or demerits of an offer'.[89] Takeover regulation in the UK and other jurisdictions that follow its approach prescribes mandatory disclosure requirements for both (i) the offer document prepared by the acquirer, and (ii) the offeree circular issued by the board of the target company making its recommendations to the shareholders on how they might wish to respond to the offer.[90] The information package made available to target shareholders has been found to be quite comprehensive.[91]

Similarly, in the US, federal law imposes disclosure requirements on acquirers when they make tender offers. For example, the Securities and Exchange Commission (SEC) stipulates that the acquirer must file a Schedule TO with the SEC 'as soon as practicable on the date of the commencement of the tender offer'.[92] This information is widely disseminated.[93] Even when a transaction is implemented as a merger, state corporate law introduces information-enhancing prerequisites. Even the deferential *Corwin* standard articulated by the Delaware Supreme Court is subject to strict disclosure obligations.[94] The Court noted that 'the doctrine applies only to fully informed, uncoerced stockholder votes, and if troubling facts regarding director behavior were not disclosed that would have been material to a voting stockholder, then the business judgment rule is not invoked'.[95]

[89] See also UK Takeover Code, r 23.
[90] UK Takeover Code, rr 23, 24; The Singapore Code on Take-overs and Mergers, GP 9, 10 and rr 8, 9; The Codes on Takeovers and Mergers and Share Buy-backs (Hong Kong), GP 5, 6 and rr 8-10.
[91] Kershaw, n 83 above, 274.
[92] Securities and Exchange Commission, 17 CFR § 240.14d-3.
[93] Claire Hill, Brian JM Quinn & Steven Davidoff Solomon, *Mergers and Acquisitions: Law, Theory, and Practice* (St. Paul: West Academic Publishing, 2019), at 135.
[94] *Corwin v KKR Fin. Holdings LLC*, 125 A.3d 496 (Del. 2015). See also, *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. 2013)..
[95] Ibid, at 312.

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Takeover regulation also stipulates that information provided in the context of a takeover must satisfy stringent requirements of care and accuracy.[96] Failure to meet disclosure requirements could lead to civil (and potentially criminal) consequences under the relevant law, whether it be the Takeover Code, corporate law, or securities regulation. Such enforcement measures would engender a culture of a fuller and more accurate disclosure, which will in turn motivate those who generate such information (whether it be the acquirer or the target's board) to act in a manner that is fair and consistent with the spirit of takeover regulation. More importantly, the disclosure obligations ensure that the takeover battle occurs in the public arena, with each move and countermove visible to all market players and observers, and subject to broader scrutiny, including in the popular press.[97]

When it comes to security screening mechanisms, however, secrecy is the norm. Governments justify this on the ground of national security and national interest. They treat cross-border takeover proposals as classified information due to the threat perception relating to such information.[98] Commentators have referred to this as the 'black-box regulatory style'.[99] This is because the governmental authorities bear no obligations to disclose the reasons for their decisions. In some instances, even the fact of a decision is known only to the parties involved in a transaction and not to the public.[100] As one commentator notes, the 'lack of transparency in the enforcement of the review might create hidden barriers in practice', suggesting that several transactions that failed security scrutiny may have 'resulted from informal and murky impediments to foreign takeovers'.[101]

Such an opaque process may act as a disincentive to foreign acquirers, who may decide to withdraw their proposals due to the lack of transparency, or may even suffer from a disincentive to launch the takeover in the first place.[102] Ultimately, the transition from a disclosure-based takeover regulation to a more surreptitious operation of the security screening mechanism will have the effect of keeping the shareholders and other stakeholders of the acquirer and the target guessing as to the outcome of a transaction and the reason behind the final disposition. As far as

[96] Kershaw, n 83 above, at 288.
[97] Narmin Nahidi, 'Media Coverage and Corporate Takeover: A Systematic Literature Review and Directions for Future Research' (2021) Available at SSRN: https://ssrncom/abstract=3970864
[98] Isaac Lederman, 'The Right Rights for the Right People? The Need for Judicial Protection of Foreign Investors' (2020) 61 Boston College Law Review 703, at 720.
[99] Bian, n 69 above, at 565.
[100] Ibid, at 584.
[101] Ibid, at 585.
[102] Ibid.

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the government regulator is concerned, the lack of transparency also diminishes accountability, a matter that is now taken up.

D. Accountability paradigm

Under conventional takeover regulation, the actions or omissions of the key decisions-makers, being corporate actors, are subject to scrutiny by regulatory and judicial authorities. For example, in the UK, allegations of non-compliance with takeover regulation go before the Takeover Panel, which can decide on the matter.[103] Appeals from the Takeover Panel lie to the Takeover Appellate Board.[104] Beyond that, the relationships between the Panel and the courts have been carefully circumscribed by judicial rulings. While no appeals lie to the courts from decisions of the Panel or the Appellate Board, the decisions of these authorities are subject to judicial review.[105]

Similarly, in jurisdictions such as the US where the courts play a more active supervisory role, the decision-making by the target's board and shareholders are subject to examination against specific yardsticks.[106] In jurisdictions where the securities regulator oversees the market for corporate control, there are appellate mechanisms established under their securities laws.[107] Overall, conventional takeover regulation lays down a well-established system of checks and balances that enhances the accountability of the decision-makers towards the constituencies who are affected by takeovers, including cross-border transactions.

On the other hand, review of decisions implementing the security screening mechanism is nearly impossible, which impinges upon the accountability and credibility of the approving authority.[108] For example, the results emanating from one study are stark:

> So far, judicial review of decisions made under acquisition- and ownership-related policies to safeguard essential security interests has been rare. One single challenge to the

[103] UK Companies Act 2006, Pt 28. See also Kershaw, n 83 above, at 120-136.
[104] UK Companies Act 2006, s 951(3). See also Kershaw, n 83 above, at 129.
[105] *R v Panel on Take-overs and Mergers, ex parte Datafin plc*, [187] QB 815; *R v Panel on Take-overs and Mergers, ex parte Guinness plc*, [1990] 1 QB 146.
[106] Robert B. Little & Joseph Orien, "Determining the Likely Standard of Review in Delaware M&A Transactions", *Harvard Law School Forum on Corporation Governance* (28 April 2017).
[107] For example, in India, decisions on takeover disputes by the securities regulator, the Securities and Exchange Board of India are appealable to the Securities Appellate Tribunal and then to the Supreme Court. See U Varottil, 'The Nature of the Market for Corporate Control in India' in U Varottil and WY Wan, (eds), *Comparative Takeover Regulation: Global and Asian Perspectives* (Cambridge: Cambridge University Press, 2018), at 361-362.
[108] Lederman, n 98 above, at 736.

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application of such policies has become known in the entire sample of 62 economies over the entire history of the field, and this case was ultimately settled.[109]

Ralls Corp. v Comm. On Foreign Inv.[110] involved a decision by CFIUS (endorsed by President Obama) to order Ralls, which was Chinese-owned, to sell a wind-farm facility which was in proximity to a sensitive government installation. While there appears to have been no doubt as to the merits of the decision, Ralls took CFIUS to court on procedural matters, including a failure to provide an opportunity to Ralls to rebut the Government's position. Although the District Court was unconvinced by Ralls's claims,[111] the DC Circuit found favour with them,[112] before the dispute was finally settled. Although one may consider the DC Circuit's ruling to open the door to CFIUS challenges by affected foreign investors, there is equally a conviction that *Ralls Corp.* has 'not emboldened investors to take the Committee and the President to court', but 'has instead made legal challenges a losing proposition.'[113] Therefore, there may be a case for enunciating the principles for judicial review more clearly and perhaps less inflexibly.[114]

Beyond procedural matters, any review of regulatory decision-making on aspects of national security or national interest would involve a great deal of complexity. This is because these concepts are devoid of precise definition, and hence their interpretation is entirely within the discretion of the regulator. Such issues have come up for consideration in Australia, where the courts have confirmed the existence of wide discretion with the relevant minister, which is beyond review by the courts.[115] This is compounded by the fact that the exercise of discretion by the government functionaries is on a case-by-case basis, which makes review by the courts more problematic.[116]

Hence, screening mechanisms vest considerable authority in the decision-makers, which imposes less accountability, if at all. When coupled with rent-seeking behaviour, this would leave constituencies affected by the screening decisions with no remedy for improper decision-making, from both substantive and procedural standpoints. While the approach of takeover regulators has

[109] OECD, 'Acquisition- and ownership-related policies to safeguard essential security interests', n 3 above, 94. See also, Steptoe, "Ralls and U.S. Government Settle Only CFIUS Suit in History" (14 October 2015) available at https://www.steptoeinternationalcomplianceblog.com/2015/10/ralls-and-u-s-government-settle-only-cfius-suit-in-history/ (last visited 5 March 2022).
[110] 758 F.3d 296 (DC Cir, 2014).
[111] *Ralls Corp. v Comm. on Foreign Inv.*, 926 F. Supp. 2d 71 (D.D.C. 2013).
[112] *Ralls Corp.*, n 110 above.
[113] Lederman, n 98 above, 7 at 19.
[114] Ibid, 7 at 36-737.
[115] Bath, n 2 above, at 13-14.
[116] Ibid, at 16-17.

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been to carefully construct jurisprudence that enables transparent and predictable decision-making on matters of takeovers, the incursion of screening mechanisms upends that clarity and instead impinges upon the accountability, credibility, and legitimacy of the decision-making process,[117] all of which are likely to have an adverse effect on the market for corporate control.

E. Chilling effects on the cross-border takeover market

The rapid expansion of the number and scope of foreign investment screening mechanisms imposed around the world have the effect of introducing a great deal of uncertainty to the legal regime surrounding cross-border takeovers.[118] The scenario imposes severe regulatory hurdles on parties intending to undertake takeover transactions, such as 'the lack of predictability in the interpretation of substantive law, the lack of procedural certainty, and the lack of transparency in practice.'[119] This creates a chilling effect on the cross-border takeover market, as acquirers may be hesitant to proceed with a transaction where the risk of regulatory failure under the security screening mechanisms is more than tolerable.[120]

Furthermore, a negation of the transaction by the government authorities after it has been announced is bound to create adverse reputational consequences on the players involved, and an unnecessary distraction for their business and management. Even where transactions display a greater likelihood of success in navigating through the screening mechanisms, the additional costs and delays associated with the process may act as a dampener to potential acquirers.[121] For example, between 2018 and 2022, cross-border takeovers of US firms by Chinese investors, which are increasingly under the heightened scrutiny of national security review, were worth about $26bn, down by 71.7% from the previous five years (2013–17).[122]

Finally, the magnification, both quantitatively and qualitatively, of the security screening mechanisms strays into the territory occupied for decades by takeover regulation that determines the outcome of a control contest.[123] Although takeover regulation and security screening

[117] Lederman, n 98 above, at 736.
[118] Westbrook, n 14 above, at 649.
[119] Bian, n 69 above, at 584.
[120] OECD, 'Acquisition- and ownership-related policies to safeguard essential security interests', n 3 above, at 100.
[121] Ibid.
[122] Alex Irwin-Hunt, 'Chinese investors slow M&A overseas: Outbound cross-border deal value in 2022 fell to a 17-year low' (*fDi Intelligence,* May 17, 2023) <https://www.fdiintelligence.com/content/data-trends/chinese-investors-slow-ma-overseas-82492?saveConsentPreferences=success> accessed 10 June 2023
[123] See Westbrook, n 14 above, at 698 (observing that "CFIUS now acts near the heart of corporation law").

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mechanisms developed independent of each other, in cross-border takeovers they have the effect of battling for the very same regulatory realm. The recent proliferation of security screening mechanisms has occurred without any consideration of its implications on the commercial aspects of takeovers as well as the regulatory regime surrounding such transactions, which are crucial for the sustenance of the market for corporate control as a key governance tool. Such a seemingly inadvertent outcome calls for unraveling the overlay between takeover regulation and security screening, a matter to which this paper now turns.

III. The Way Forward: Reconciling NSR with Takeover Regulation

To be sure, it is hard to argue against the need for screening mechanisms as a means to safeguard national security and to preserve national interest.[124] However, concerns arise from the manner in which security screening mechanisms have expanded, and the resulting paradigm shifts that seem to create a dichotomous legal regime. Consequently, administrative agencies have been conferred an enormous amount of discretion under an investment screening procedure that is tainted by politicisation, ambiguity, uncertainty, and protectionism.[125] Concomitantly, shareholders, boards and other private actors have been denied any powers to consider the merits of a takeover that has been blocked by the government authorities.

This section delves into the question of how international efforts might be supplemented or crystallised through harmonisation, allowing jurisdictions to align their domestic legal structures to lessen the detrimental effects stemming from the intersection of screening mechanisms and takeover regulations.[126] In achieving the appropriate balance, regard can be had to the principles embedded in the OECD Guidelines for Recipient Country Investment Policies relating to National Security.[127] The OECD Guidelines are premised on four principles:[128]

[124] Martin Gelter, 'Is Economic Nationalism in Corporate Governance Always a Threat?' (28 January 2022) European Corporate Governance Institute - Law Working Paper No 626/2022, Available at SSRN: https://ssrncom/abstract=4020333

[125] Esplugues, n 8 above, at 449-450.

[126] Proposals to manage security screening mechanisms at the level of international law, be it bilaterally or multilaterally, persistently gain traction among academics and policymakers. It is suggested that, inter alia, bilateral investment treaties (BITs), such as the EU-China Comprehensive Agreement on Investment, could be leveraged to incorporate cooperative and reciprocal principles of non-discrimination, transparency, predictability, regulatory proportionality and accountability to achieve the regulatory objectives of EU Regulation 2019/452. See Bian, n 69 above, at 595.

[127] OECD, Recommendation of the Council on Guidelines for Recipient Country Investment Policies relating to National Security, OECD/LEGAL/0372, adopted on: 25/05/2009.

[128] Ibid, Guidelines 1 - 4.

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1. Non-discrimination: policy makers ought to ensure equal treatment for all investors subjected to the screening mechanism.
2. Transparency and predictability: regulatory policies should champion utmost transparency, thereby facilitating predictable outcomes.
3. Regulatory proportionality: NSR implementation should be proportionate to the perceived risk to national security it aims to mitigate.
4. Accountability: regulatory process must be held accountable, not only to the citizens of the host jurisdictions but also to the foreign investors who find themselves under the scrutiny of these screening mechanisms.

As the analysis in this paper highlights, the current NSR mechanisms do not comport well with the above four principles outlined by the OECD. Hence, the objective herein is to offer an alternative framework that is more consistent with these principles. On the one hand, there is a compelling need to broaden the scope of conventional takeover regulation to incorporate concerns of national security and national interest as part of the determination of the success (or failure) of a takeover offer. On the other hand, this expansion must be accompanied by appropriate adjustments in the security screening mechanisms by instilling checks and balance so that they operate in a manner that is consistent with the above four principles.

A. Reorienting takeover regulation

There already exist readily identifiable governance mechanisms, either in the corporate governance structure at the firm level or in the functional regulatory structure at the institutional level, that would mitigate the contingent impacts on national security of unsolicited and value-reducing cross-border acquisitions. Principles like equality, transparency, certainty, proportionality and accountability are profoundly embedded in the existing takeover regimes and are eminently viable to assess national security issues pertaining to a cross-border takeover transaction.[129] At the best, national-level screening regimes should be retained as supplementary and complementary systems.

[129] Esplugues, n 8 above, at 245-253.

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1. Empowering shareholders

In the face of bids, takeover regulation has contributed mechanisms to assess the merits of an offer. Incumbent shareholders of a target company, aided by the recommendations of the directors, decide whether to tender their shares or hold on to them (and, in turn, determine the success or failure of the offer). National security screening, in contrast, offers the target company a defensive device, a shield in the battle for corporate control, which is above and beyond the conventional takeover regimes.[130] For example, in the wake of FIRRMA, CFIUS's screening apparatus has been conferred a much broader scope while working on issues of national security. As one commentator has noted:

> …[t]he expansion of CFIUS review, at a minimum, has made the corporate governance benefits of the market for corporate control more expensive. The deployment of CFIUS review at the discretion of the target board, moreover, can wipe out shareholders' rights to consider an unsolicited offer or vote for insurgent directors sponsored by potential acquirers.[131]

Due to this scenario, it is necessary to ensure that shareholders continue to retain their say in determining the fate of the acquisition. In doing so, they can have regard not only to the financial aspects relating to the offer, but also to widening national interests. Such a suggestion is by no means a pipedream. For instance, following the controversial takeover of Cadbury in the UK by Kraft, shareholders of a target company are entitled to consider the views of the board on matters relating to employees, and also to benefit from the opinion of employee representatives directly, before the shareholders decide the outcome of an offer.[132] Furthermore, shareholders are also entitled to information regarding the bidder's plans for the target, including matters such as the intentions regarding research and development functions, any possible change of terms and conditions in employment, location of the headquarters of the target and other places of business,[133] all of which bear significant national importance.

Such an expanded view is consistent with other developments surrounding the advancements in environmental, social and governance (ESG) considerations that have begun to acquire

[130] Westbrook, n 14 above.
[131] Lederman, n 98 above, at 696.
[132] UK Takeover Code, rr 2.7, 2.11, 24.2 and 25.2.
[133] Ibid, Notes on r 2.7.

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significant importance in corporate voting,[134] but also with the theoretical discourse surrounding the widening of the corporate purpose beyond shareholder interest.[135] Shareholders must, therefore, be provided the opportunity to signify their position regarding the national interests involved in a cross-border takeover. They could do so by way of a shareholder resolution, even a precatory one.[136] The expectations demonstrated by the shareholders in such a resolution must be one of the factors to be considered by the government authority while deciding the issues of national security and national interest. In such a dispensation, takeover regulation and screening mechanisms work in tandem.

2. Enhancing board compliance

At the outset, boards of the target company are obligated to provide information and offer their recommendations on matters that shareholders can ultimately decide, as discussed in the previous sub-part. In addition, target boards can themselves establish an eligibility regime that would screen potential bidders. This would help target boards weed out strategic buyers backed by foreign states who are driven by non-financial motivations, or whose acquisitions may otherwise impinge upon the national interests of the jurisdiction where the target is incorporated or listed.[137]

Among other existing mechanisms, obligations may be imposed on a special committee of independent directors of the target to marshal significant outside expertise to investigate and verify the credibility of an acquirer's motives for a takeover bid, and to make recommendations to the shareholders on that basis.[138] In that sense, in making recommendations to shareholders, directors ought to be guided not merely by financial outcomes that shareholders may enjoy, but also a consideration of matters of national security and national interest. The imposition of obligations

[134] Hao Liang and Luc Renneboog, 'Corporate Social Responsibility and Sustainable Finance: A Review of the Literature' (European Corporate Governance Institute – Finance Working Paper No. 701/2020, 24 September 2020) at SSRN: https://ssrn.com/abstract=3698631.

[135] Edward B. Rock, 'For Whom is the Corporation Managed in 2020?: The Debate over Corporate Purpose' (European Corporate Governance Institute - Law Working Paper No. 515/2020, 1 May 2020) at SSRN: https://ssrn.com/abstract=3589951 (last visited 15 March 2022).

[136] For the value of precatory resolutions, see Andrew R. Brownstein and Igor Kirman, 'Can a Board Say No When Shareholders Say Yes? Responding to Majority Vote Resolutions' (2004) 60 Business Lawyer 23.

[137] As for a broader discussion of bidder eligibility mechanisms, see Gordon and Milhaupt, n 8 above, at 202.

[138] See Scott V. Simpson and Katherine Brody, 'The Evolving Role of Special Committees in M&A Transactions: Seeking Business Judgment Rule Protection in the Context Of Controlling Shareholder Transactions and Other Corporate Transactions Involving Conflicts of Interest' (2014) 69 Business Lawyer 1117.

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on private actors such as the board of directors and shareholders of the target company to account for public interest is by no means a stretch.[139]

The more significant question relates to whether such powers in the hands of the board or a special committee can be subject to abuse, by which they act as a *de facto* takeover defence. As seen earlier, the current wave of proliferated NSR mechanisms has been exploited by target boards to fend off unsolicited takeover bids, thereby earning the moniker of a 'super poison pill'.[140] This is evident from the failed takeovers of Qualcomm by Broadcom in the US and that of Rio Tinto by Chinalco in Australia.[141]

In the context of expanded national security screening mechanisms, the above approaches might amount to either under-regulation or over-regulation. Under the UK rule, target boards are inept to respond to national security concerns as, after all, they can only advise shareholders; under the US rule, target boards may have the power to 'just say no' to takeover bids.[142] Regardless of the nature of the takeover regulation, target boards could unduly trigger the security screening mechanism, thereby depriving the shareholders to have access to an offer.

To address such a regulatory gap, one could resort to the special committee of independent directors to enhance the board compliance system in relation to takeovers.[143] The target company shall comply not with the takeover rules as they are but, where national security issues might be anticipated, the compliance must be based on the special committee's understanding of the issues after making due enquiry. The enhanced compliance oversight recognises that, on the one hand, the shareholders will retain their decision power but, on the other, it encourages the board to act proactively to mitigate and respond to national security concerns when they emerge.[144]

The directors of the target company, including those who are serving on the special committee, will be subject to the usual fiduciary duty regime in discharging their responsibilities. In particular, where the target's board invokes its power to trigger a security screening mechanism to fend off a takeover, its conduct could be subject to review against the touchstone of the directors' duty to act

[139] See nn 134-135 and accompanying text.
[140] Westbrook, n 14 above, 646. See also, Yiheng Feng, 'We Wouldn't Transfer Title to the Devil: Consequences of the Congressional Politicization of Foreign Direct Investment on National Security Grounds' (2009) 42 New York University Journal of International Law and Politics 254, at 267.
[141] See Westbrook, n 14 above and accompanying text.
[142] Robert B. Thompson, 'Shareholders as Grown-Ups: Voting, Selling, and Limits on the Board's Power to "Just Say No"' (1999) 67 University of Cincinnati Law Review 999
[143] John Armour, Brandon Garrett, Jeffrey Gordon and Geeyoung Min, 'Board Compliance' (2020) 104 Minnesota Law Review 1191.
[144] Patrick Warczak, 'Giving Compliance its Due: Caremark Duties in the Context of Mergers and Acquisitions' (2021) Available at SSRN: https://ssrncom/abstract=3971236

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for proper purpose,[145] especially as this duty tends to be invoked primarily in battles for corporate control. For instance, a crucial question would be whether the invocation of the security screening mechanism was dictated by the directors' motive of self-preservation or for the protection of national interests.[146] In all, a reorientation of the existing corporate law and takeover regulation would enable the private actors to perform a role in the determination of national interests, even if it is only to highlight their position to be considered by the regulatory authorities overseeing national interest concerns.

B. Readjusting screening mechanisms

As the episode involving the prohibition of Qualcomm's acquisition by Broadcom clearly indicates, the CFIUS possesses nearly untrammelled power to block a foreign takeover transaction. This power enables CFIUS as well as the US President to operate 'near the heart of corporation law'.[147] In order to enable takeover regulation and screening mechanisms to operate in a harmonious manner, it is vital to disentangle takeovers from the excessive influence of NSR mechanisms.

Here, we put forth two specific recommendations. First, arising from the discussion in the previous sub-part, it is essential for government authorities implementing screening mechanisms to ascertain the wishes of the shareholders, board, and other stakeholders of the target so that decision-making under the screening mechanisms is not entirely inconsistent with the need to preserve the integrity of the market for corporate control.

Second, the decision-making process under the screening mechanisms must be subject to a greater level of accountability that is currently lacking. In comparison to conventional takeover regulation, where the actions of shareholders or directors are subject to external supervision, the process and outcomes of the national security screening review process 'shall not be subject to judicial review.'[148]

Even post-*Ralls*, there is very little possibility of the affected parties (be it the company, its board or shareholders) being able to overturn the screening decision. Hence, one potential solution

[145] See Ross Grantham, 'The Powers of Company Director and the Proper Purpose Doctrine' (1995) 5 The King's College Law Journal 16.
[146] As for the tests regarding the application of the proper purpose duty, see *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; *Eclairs Group Limited v JKX Oil & Gas Plc* [2015] UKSC 71.
[147] Westbrook, n 14 above, at 698.
[148] Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49, § 6, 121 Stat. 246, 256.

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would be to expand the scope of judicial review of decisions taken under screening mechanisms. This would require legislative amendments as well as proactive judicial engagement. This can lead to the establishment of overarching principles regarding the screening authority's jurisdiction, fostering greater consistency and predictability for market participants and other stakeholders.[149]

Critics of the above proposal may contend that subjecting NSR decisions on cross-border takeover to judicial review will undermine the government's efforts to protect national security and national interests. However, seeking a more streamlined and transparent procedure need not necessarily weaken the robustness of the screening mechanism.[150] For instance, in case of sensitive industries or sectors, where a public process of screening could itself expose to security or national interest threats, the review can be held through in-camera proceedings and any documents released after redacting sensitive information.[151]

IV. Conclusion

This paper aimed to explore the repercussions of the global proliferation of security screening mechanisms on cross-border acquisitions, particularly focusing on the administration of conventional takeover regulation in the market for corporate control. It concluded that the swift expansion of these mechanisms encroaches upon the domain traditionally occupied by takeover regulation. This not only impacts the structuring and execution of cross-border takeover transactions but also, due to the conflicting considerations underpinning the two regulatory frameworks, results in suboptimal outcomes. Conflicts arise from divergent perspectives on whose interests should be prioritized in determining the progression of a takeover, the identification of primary decision-makers, the public or confidential nature of takeover battles, and the accountability of decision-makers. The advent of security screening mechanisms has marked a significant shift in these aspects, prioritizing national interests at the expense of the private interests of corporate entities engaged in takeover disputes.

While solutions to this dilemma may partially reside in international law, this paper primarily focuses on mitigating factors involving the reshaping of domestic law concerning both

[149] Lederman, n 98 above, at 741.
[150] Tipler, n 8 above, at 1272.
[151] See Margaret B. Kwoka, 'The Procedural Exceptionalism of National Security Secrecy' (2017) 97 Boston University Law Review 103.

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security screening and takeover regulation. This necessitates the broadening of takeover regulation to include considerations such as national security and national interest, coupled with enhanced flexibility and accountability in the security screening process. This paper advocates for the redefinition of the boundaries between takeover regulation and security screening mechanisms. This reconfiguration aims to delicately balance the dual objectives of safeguarding national interest and fostering a market for cross-border takeovers, all while adhering to norms of proportionality, transparency, and accountability.

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