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THE RISE OF ECONOMIC PATRIOTISM AND ITS IMPACT ON CROSS-BORDER MERGERS AND ACQUISITIONS: REDEFINING THE HORIZONS OF GOVERNMENT INTERVENTION

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ABSTRACT

Globalisation is approaching its pinnacle by steadily blurring national boundaries and integrating national economies to create an inevitably interdependent world economy. The UK has always been conscious of such interdependence while formulating its business regulations. A prime example of such conscious policy-making is the UK's open FDI policy, which fosters acquisition of UK based companies by foreign bidders with almost no restrictions. Lately, this ease of acquisition has led to the loss of vital UK companies to foreign competitors. Further, the global has witnessed drastic changes that present unseen challenges to national security not accounted for in UK's existing takeover regime. The complexities of this external change are intensified by the domestic uncertainties of Brexit and UK's newly assumed nationalist disposition. The fundamental question germinated by these circumstances and concerns is whether the UK government should have greater powers to intervene in the acquisition of a UK based company by a foreign bidder. This paper thus seeks to address this very question; although this debate has been alive in speculation and political commentary, it has yet to produce any substantial results or firm commitments.

Key Words: cross-border acquisition, foreign bidder, government intervention, national security

INTRODUCTION

On 17 February 2017, Kraft-Heinz launched an unsolicited bid for Unilever PLC and sent United Kingdom's (UK) political and business community into a frenzy (Clements, 2017). Kraft-Heinz, an American company backed by 3G Capital and Warren Buffet's Berkshire Hathaway Inc., can be best described as the meanest shark in the ocean of capitalism (Berman and Kenwell, 2017). Ironically, one of the milestones that earned it this reputation was its takeover of Cadbury, another iconic British company, in 2010 (Business Innovations and Skills Committee, 2009, p. 5). Unilever on the other hand is a thriving Anglo-Dutch consumer goods mammoth respected for its commitment to long-term sustainability. Over the three days of hostilities that ensued, Unilever employed every trick in the book to thwart the bid until Kraft-Heinz amicably backed off, stating it was not interested in a hostile takeover (Boland, 2017, p. 7). The bid was a rude awakening for both Unilever and the UK government. The government, although publicly opposed to the takeover, was absolutely powerless to control the bid's outcome. This situation reopened old wounds inflicted during the controversial Cadbury takeover, which had resulted in losses of every variety for the UK and its citizens (Patrone, 2011, pp. 64-66). Once again, the UK government and a vital British company, along with its employees, assets, innovations and industry domination, were in a sinking boat in the foreign ocean of capitalism, with no lifejackets capable of rescuing them. This seemingly distressing situation gives rise to many question of excruciating importance. What if Kraft had relentlessly pursued Unilever, raising its offer price until it drew blood? Could the UK government have taken any action except to clench its teeth in anger while

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sitting with folded hands? Should the UK government make provisions for lifejackets in the form of government intervention for the next time this turbulent ocean approaches its shores?

In this paper, I aim to answer the above questions and suggest a way forward. Section 2 explores the factors prevailing domestically in the UK and in the global marketplace that favour government intervention, and it finds appreciable evidence in support of greater intervention. Section 3 conducts a comparative evaluation of the power of intervention wielded by the governments of other similarly placed and respected jurisdictions. This part alarmingly concludes that other jurisdictions have raced past the UK to ensure the protection of their "national interests", and urges for the introduction of measures to help the UK keep pace. I then conclude in Section 4 by advocating a calculated increase in the powers of intervention without losing sight of the valid purpose of such a power and the need to balance it with other objectives. Thus, this paper aims to add to a very recent and crucial debate, especially in the UK, and endeavours despite the limited literature to assert its standpoint forcefully.

A CASE FOR GOVERNMENT INTERVENTION IN UK: NEW CHALLENGES AND OPPORTUNITIES

The UK's present politico-economic environment has shown a nationalist inclination and is constituted of various intertwined factors fuelling a debate on economic patriotism. This section of the paper attempts to analyse the most pivotal of these factors respecting takeovers by foreign bidders.

1. The fall in the number of "National Champions"

Since the Brexit vote, UK has lost heavyweights like ARM Holdings, WS Atkins and (most recently) Worldpay to foreign acquisition (Massoudi, 2016, p. 3; Burton, 2016, p. 12; Pooler, 2016, p. 5). Additionally, there have been several failed bids to acquire high-profile companies, such as Pfizer's bid for AstraZeneca (the UK's largest pharmaceutical company) and Kraft-Heinz's bid to acquire Unilever. These companies are at the forefront of vital industrial sectors critical to British prosperity, making their acquisition a national loss. Declining numbers of such "national champions" has profound implications for the UK's employment opportunities, innovation, infrastructure, industry dominance, long-term economic supremacy, etc. (Kastrati, 2013, p. 31-33). This situation is worsened by the acquirer, which in most cases are tax-dodging and profit-seeking corporations, capitalists and private equity firms (Pwc, 2017, p. 18-24). For instance, Pfizer itself confessed to tax avoidance as one of its objectives for acquiring AstraZeneca. Such acquisitions are made easier by the recently depressed value of sterling in the midst of Brexit uncertainties, which is expected to continue at it lowest in the near future (Martin, 2017). Such a predatory pattern elicits the demand for protectionist measures to shield UK's companies from foreign siege at a time when they are most vulnerable.

2. The Conservative government's standpoint

During her electoral campaign in 2016, Theresa May, Prime Minister of the UK, reflected upon AstraZeneca's potential takeover and suggested that the government should have the power to intervene in such bids (Parker, 2016, p. 6). The Conservative government has continued to hold this opinion and has time and again given statements about its intention to undertake a complete review of the takeover regulations (Lascelles and Luque, 2016).

Recently, the government's willingness to intervene in cross-border deals was demonstrated by its decision to delay approval of Hinkley Point C, a project to develop a nuclear power station in Somerset led by EDF, a French state-owned corporation and state-backed China General Nuclear Power Corporation (Ruddick, 2016, p. 7). It was speculated

that the delay resulted from national security fears due to Chinese involvement in the project (Ruddick, 2016, p. 7).

The above statements evidently highlight the government's hypersensitivity to foreign takeovers and its growing protectionist sentiment. However, being aware that any such policy change will imply a monumental shift from the present laissez-faire approach, the government is carefully reviewing its options while waiting for the opportune moment. Thus, with a government more supportive of calculated protectionism than any of its predecessors, the UK's departure from a historically open economy might be on the horizon.

3. Disguised opportunities presented by Brexit

As a member of the European Union (EU), the UK is bound by the European Union Merger Regulation (EUMR) to regulate all takeovers that fall within its scope. Article 21(3) of this regulation prevents national legislation from interfering with its operation. Resultantly, the government is incapable of blocking any deal once the European Commission (EC) has approved it largely on competition grounds. Although Article 21(4) provides certain exemptions allowing member states to protect their legitimate interests, these exemptions are rarely granted. On being asked to comment upon the expected changes to the takeover regime post Pfizer's bid for AstraZeneca, the Secretary of State rightly noted that the UK operates "within serious European legal constraints" in considering any extension to its public interest powers (*HC Deb*, 2014-15).

Brexit presents the government with unprecedented opportunities in this regard. Giving credence to informed opinions and well-supported speculation, it is likely the UK will exit the EEA post a hard Brexit, thus rendering the EUMR inapplicable (Edwards, 2017; Clifford Chance, 2016). This will finally bestow the government with the freedom to draft a tailored takeover policy with its chosen measure of protectionism.

4. The rise of State Wealth Funds (SWFs) and State-Owned Entities (SOEs) in the MandA landscape

The continuous ascent of SWFs and SOEs as major players in the global market has been the axis of worldwide media attention and government scrutiny. In 2015, SWFs alone owned assets worth USD 11.3 trillion, projected to reach USD 15.3 trillion in 2020 (Pwc, 2016). The fear surrounding the expanded role assumed by governments in global market deals is primarily based on national security concerns (Mation, 2016, pp. 494-496). In particular, the Chinese SOEs find their motives questioned routinely by national governments and media alike.

To effectively address these legitimate security concerns, national governments have already amended – or are in the process of amending – their takeover policies. The US Congress passed the Foreign Investment and National Security Act 2007 (FINSA) requiring the Committee on Foreign Investment (CFIUS) to compulsorily review foreign investments by sovereign acquirers. Similarly, in 2009, the German Foreign Trade and Payments Act was amended to allow the German Federal Ministry of Economics and Technology to prohibit non-EU investors from acquiring German enterprises on security or public policy grounds. This has been further amended in 2017 and will be discussed later. The Australian Foreign Investment Review Board (FIRB) has also advanced in this direction by publishing a detailed policy requiring direct investments by foreign governments and their related entities to be treated differently from other acquisitions in terms of substance and applicable procedures.

In the light of these developments, the UK's inaction is not only surprising but also potentially incautious. According to the World Investment Report 2017, the UK is the second most targeted nation for government-led acquisitions worldwide, while the US is the prime target (United Nations Conference on Trade and Development, 2017, p. 8). The US, however,

addressed these concerns in a timely manner by undertaking legislative action, and even European nations (which famously advocate the free-market principle) have recognised the need for differential treatment of sovereign acquirers. Thus, I believe the question should no longer be whether the UK needs to implement policy changes to tackle government-led takeovers, but when such inevitable changes will be implemented.

5. Socioeconomic concerns

A takeover activity is never purely economic, since its effects are borne by various socioeconomic factors (Kastrati, 2013, p. 31-33). The free market approach to takeovers surrenders these socioeconomic factors to the self-regulating international markets, frequently leading to unintended consequences. The British government has faced such consequences on several occasions and is yet again helpless in the face of the deal between General Motors (GM) and PSA Group to sell GM's loss-making Opel and Vauxhall subsidiary to PSA (Kable, 2017). Vauxhall has two factories in UK, directly employing 4,500 workers and engaging another 27,000 people in UK's retail and supply network; all of these jobs are now at stake (Wearden, 2017, p. 5). The failed Kraft-Heinz bid for Unilever would have presented a much greater threat to the 7,500 Unilever employees in the UK, especially given its ruthless cost-cutting reputation (Whipp, 2017, p. 9). Such a loss of jobs at the hands of a foreign acquirer will not be new for British citizens who have been left unemployed on earlier occasions, for example, as a result of the Cadbury, Jaguar and Land Rover, and BBA takeovers.

In a time when the Brexit vote has patently demonstrated the people's predilection for protecting their jobs, losing jobs to increase a foreign acquirer's profit margins will be vehemently unacceptable to British citizens. Thus, at this juncture of Brexit with the UK's strong nationalism, the public will expect the government to defend them from predatory capitalists who seek profits at the expense of the UK's society, economy and long-term prosperity.

Historically, the UK has been an exemplary free-market economy that proudly boasts of the world's most open takeover regime (Deresky, 2015). Any shift from this widely-advocated stance by UK must therefore be grounded in well-founded and economically sound reasoning. It is argued that the above-assessed grounds possess the combined potency to justify government intervention. The UK government must acknowledge that this is the golden age of shareholder-first capitalism wherein the interests of "here today, gone tomorrow" shareholders can no longer be allowed to dictate the long-term interests of the society, the economy and the nation. Thus, it is contended that the UK government should no longer hold onto past notions of an idealistic takeover policy and initiate necessary reform.

THE SCOPE OF GOVERNMENT INTERVENTION IN SELECTED JURISDICTIONS

This section seeks to provide an overview of the policy changes respecting takeovers by foreign acquirers implemented or considered by certain economic superpowers, namely the US, Australia and the EU, with a focus on the reasons that have prompted their policy changes. This analysis will help draw comparisons with the UK's current situation and provide a catalogue of the various approaches adopted by similarly-placed economies.

1. The US: a takeover regime revolving around "national security"

The US is a longstanding champion of an open FDI policy and attracts the highest inward foreign investment year after year (United Nations Conference on Trade and Development, 2017). In 1988, due to circumstantial necessity, the US amended section 721 of the Defense Production Act 1950 to enact the "Exon-Florio Amendment". This amendment authorised the President to block foreign investments presenting a threat to US national security. CFIUS is

the primary vehicle for executing Exon-Florio and is responsible for conducting a national security review of transactions by foreign acquirers. Recently, two particularly controversial takeover attempts caused a furore in the Congress, which attacked the CFIUS review process as inadequate and lax. First, in 2005, CNOOC – an oil company with a 70% Chinese government stake – sought to acquire UNOCAL, an American oil company (Nanto and Jackson, 2006). Second, in 2006, Dubai Ports World, a Dubai state-owned company, gained requisite regulatory approval to purchase the management rights of terminals at five American ports (Malwaki, 2011, pp. 170-174). Both these transactions crumbled under the immense political pressure exerted by Congress, with CNOOC forced to withdraw its bid and DPW forced to sell the rights to a US entity (Mamounas, 2007, pp. 416-419). This congressional thrust triggered the further amendment of Section 721 of FINSA with an aim of formalising the review process to enhance the protection of national security.

CFIUS may review "covered transactions", either on voluntary notification by the parties or unilaterally. FINSA defines a "covered transaction" as "a transaction by or with a foreign person that could result in control of a US business by a foreign person." Investigation is mandatory where a transaction (1) would result in foreign control over critical infrastructure and (2) could impair national security. On completing the investigation, a recommendation is made to the President, who exercises the ultimate authority to either approve or prohibit the transaction.

The new formalised review process has faced several criticisms, the key concerns being the expansive scope of "national security" and the alarming influence of Congress. FINSA purposefully omitted to define the term "national security", although a subsequent guidance was published by the Treasury Department, which instead provides the factors considered by CFIUS in determining national security threats (United States of America, Department of the Treasury, 2008). These factors (such as potential national security-related effects on US critical infrastructure, international technological leadership in areas affecting US national security, etc.) are themselves open to unbounded interpretations. Thus, a potential foreign acquirer is left vulnerable to uncertainty and excessive costs (United States of America, Department of the Treasury, 2008). The second concern regarding increased congressional influence stems from the easy access afforded to several members of Congress (including their staff) to confidential information relating to reviewed transaction (Stagg, 2007, p. 360). Increased congressional influence opens the door for factors such as lobbying, pressure tactics by special-interest groups, public appeasement and political agenda in a room reserved for objective decisions on national security. Apart from the above, other concerns (such as the uncertainty injected by authorising CFIUS to review a closed transaction at any time, the secrecy of CFIUS's internal process and the dangers of reciprocal retaliation towards US investment from countries like China) have raised doubts as to the motivations and merits of enacting FINSA (Li, 2017).

Although any comment on the comprehensive impact of this enactment will be premature, it is believed that the true value of this regime lies in its function as a deterrent to ill-motivated takeovers and its potency as a weapon against national security threats (Tipler, 2014).

2. Australia: a fearless approach towards the protection of "national interest"

Despite being rated by the OECD as a country that maintains a restrictive foreign investment regime, Australia is a significant beneficiary of foreign investment in the global acquisition landscape (Organisation for Economic Cooperation and Development, 2016). Recently, the Australian takeover regime has received considerable scrutiny following a decision to block two foreign bids by China's State Grid Corporation and the Hong Kong-based Cheung Kong

Infrastructure for acquiring Ausgrid, an Australian electricity company (Smyth, 2016, p. 4). Displaying a rising sensitivity to Chinese investments, especially after a transaction wherein China's Landbridge Group acquired the lease to Darwin port (a strategically important area), the government in January 2017 ordered a full-scale review of its critical infrastructure and the development of a register of key infrastructure ownership to strengthen the review of bids relating to critical infrastructure (Attorney-General for Australia, 2017). Earlier, Australia also updated their Foreign Investment Policy to include additional regulatory requirements for "foreign government investors". In response to accusations of protectionism, the Head of Australian Strategic Policy Institute commented, "I don't think Australia should be embarrassed to say that we will have at least a strong protection of our national security interests around critical infrastructure, as the Chinese do around their critical infrastructure" (Iggulden, 2016).

Australia's takeover regime is governed by the Foreign Acquisitions and Takeovers Act 1975 (FATA), which stipulates a case by case review of proposals and a mandatory review of proposals by a foreign government or a related entity, introduced in 2015. The treasurer must determine whether the proposed acquisition is contrary to "national interests". Although FATA does not prescribe a definition of "national interest", the Foreign Investment Policy of Australia as updated in January 2016 provides the factors considered by the treasurer in making such a determination, such as national security, competition, impact on the economy, analysis of Australian participation and the interests of employees, creditors and other stakeholders, the character of the investor, etc. Resultantly, the acquisition is approved, rejected or approved with conditions, which is more usual than rejection.

The "national interest" test is criticised for being a flexible ploy of expansive scope creating room for political influence and occasional strong-arming (Bath, 2012, p. 16). The case-by-case review mechanism also lacks predictability, evoking mistrust in the review process. However, past experience contains little evidence of arbitrary determinations by the treasurer, with rare instances of rejection (Bath, 2012, p. 17). The Australian model advocates that an open investment policy does not necessitate the limiting of national interest to purely defence considerations; an expansive interpretation is in fact suitable and acceptable in light of the challenges presented by takeover bids, particularly by governments-controlled acquirers.

3. The EU: navigating the concept of protectionism

The EUMR, as discussed earlier, regulates all takeover activity that exceeds the required revenue threshold through the EC. The EC reviews the proposed takeover bid on competition grounds, and if a takeover is considered "incompatible with the common market" it is either prohibited or approved with mitigating conditions. Under Article 21(4), the member states are permitted to intervene with the EC's determination only for the protection of their legitimate public interest, and consideration of any other interest is dependent upon its compatibility with EU principles. However, if the threshold is not met, the individual member states are authorised to regulate the takeover in accordance with their domestic law.

In the last decade, the EU has witnessed a surge of protectionist sentiment evoked by various factors and particularly orchestrated by France, Germany, Italy and Belgium. The recently-elected French president has publicly supported the protection of "national security" through the EU mechanism (Beesley, 2017, p. 12). In Germany, the government adopted a directive in 2017 expanding its current power to block the acquisition of a German entity in excess of 25% by a non-EU acquirer if the takeover threatens public order or national security, to include companies providing critical infrastructure.

At the EU level, however, there is an absence of any power to prohibit transactions on national security or interest grounds. This handicaps all the member states and has thus

catapulted this concern to EU's immediate agenda. A paramount concern for the EU is the wave of acquisitions by Chinese firm in strategic sectors, particularly advanced technology, while China continues to place numerous restrictions on inward investment by member states (Hanemann and Huotari, 2016). Consequent to these concerns and developments, on 13 September, the EC president announced measures to tackle this apparent lacuna in the EU regime (Lakhdir and Cristie, 2017). The EC has proposed a framework that authorises the member states to screen FDI on security grounds while simultaneously authorising the EC to screen such FDI, which can potentially affect projects of Union interest (such as projects involving critical infrastructure or technology) on security grounds. Pending the formalisation and adoption of the draft regulation, the proposal is being lauded as a brave and unexpected step capable of addressing the concerns and fears of the EU member states.

In conclusion, this section emphasises the overriding common threads between each jurisdiction's developments, namely heightened sensitivity in respect of critical infrastructure and hyper-cautiousness towards government-controlled acquirers. As discussed above, the UK is equally vexed by these concerns, the only difference being that other jurisdictions have already ushered in reforms despite criticism and allegations. The above-discussed jurisdictions continue to remain proponents of an open FDI policy, since the strength of their policies lie in deterrence rather than application. However, each jurisdiction is struggling to ensure the separation of decision-making power and political influence, both in substance and in appearance.

CONCLUSION

The takeover regime in the UK is a unique union of different legislations and rules that seamlessly integrate and purposefully overlap to produce a swift, certain and flexible regulatory mechanism. The principal legislations and rules that together constitute the takeover regime are the City Code on Takeovers and Mergers, the EUMR, the Enterprise Act 2002 (EA) and the Companies Act 2006. The EA affords the UK government the power to intervene in a takeover bid in very limited circumstances, but even this power is curtailed by the EUMR. Interventions within the EUMR's narrow exceptions are further subject to EC review and can be overturned by an ECJ infringement ruling.

In cases of mergers outside the scope of EUMR, Section 58 of the EA empowers the Secretary of State to issue a Public Interest Notice (PIN) if they are satisfied that any public interest consideration (which under the EA is limited to national security, plurality of the media, and stability of the UK financial system) is threatened by the given takeover transaction. Once issued, the PIN transfers the decision-making power to the Secretary of State, who has the discretion to either remedy the adverse effects by exercising enforcement powers or prohibit the acquisition. Even this authority is rarely exercised. predominantly due to the limited legitimate interests protected by the act. The exemption of "national security" as defined under the EA is robbed of its inherently wide scope, since its definition is based on the narrow definition of "public security" under Article 21(4) of the EUMR. Thus, the UK government is often said to have the most hands-off approach to takeover control as compared to any other jurisdiction.

I believe this regime has remained stagnant in the face of challenges that have demanded acknowledgment through realignment of its objectives. The role of the key market-players, particularly the government, must adapt to face the challenges discussed in the preceding section in a way that best serves the interest of UK's economy. It is suggested that the revised framework should refrain from introducing radical changes to the present takeover policy and regime such as the introduction of a separate statutory review body similar to CFIUS. Primarily, this is to avoid differing compliance regimes within the UK and EU post-Brexit leading to onerous and lengthy investigations and opposing outcomes. Such

inconvenient policy divergences between the former member states can induce hostility and possible retaliation from the EU (Buckle et al., 2015, p. 60-66). Further, I believe that, with the suggested amendments, the existing EA framework is highly capable of achieving the said objectives. Therefore, the UK should not overplay its likely freedom from the EUMR to its own detriment, but should only utilise it to the extent necessary while striving to promote cooperation with the EU. In respect of SWFs and SOEs, it is suggested that, unlike many other jurisdictions, they should not be discriminated against by subjecting their takeover proposals to compulsory scrutiny. The reason supporting uniformity of treatment is that the takeover regime should be grounded in commercial and rational considerations instead of the acquirer's identity in the absence of any reliable data warranting such discrimination. In fact, one study concluded that the determinants influencing the takeover decision of a government-controlled acquirer and a commercial acquirer vary >1%, thus eliminating political motivations (Karolyi and Liao, 2010, pp. 20-23).

In conclusion, the UK government must undertake measures to protect critical infrastructure and national security by appropriately amending the EA, expanding the use of golden shares to prevent takeovers provided UK leaves the EEA or/and introducing various sectorial restrictions on foreign investment to protect strategic sectors can restrict their acquisition by sovereign acquirers. However, any increase in the powers of intervention must be carefully calculated and appropriately restrained to ensure the UK's openness to FDI and commercially motivated foreign acquisitions.

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