EU Policy & Regulatory Alert: New Regulation on Foreign Direct Investment Screening in the EU

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By: Bertold Bär-Bouyssière | Joaquin Hervada

On Tuesday, 20 November 2018, the Council of the EU and the European Parliament reached a provisional agreement on a future EU-wide coordination mechanism and information exchange for the screening of inward foreign direct investments (FDI) in the fields of EU strategic interest (Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union). The new Regulation is expected to enter into force following its formal adoption by the Member States, likely in early December, and by Parliament in February or March 2019.

Background of the EU proposal

While many other major jurisdictions such as the US, Australia, Canada and Japan have FDI screening mechanisms in place, the EU as a bloc possesses no comparable single mechanism. Less than half of the EU Member States currently have legislation in place, allowing them to review FDI on grounds of national security or public order.

The new Regulation is the EU's response to the rapid developments and increasing complexity in the investment landscape. It aims to strike a balance between maintaining the EU's general openness to FDI inflows and protecting the EU's core interests. The recent surge of foreign investments in EU firms and strategic infrastructure in particular by foreign (most notably, Chinese) state-owned enterprises or private firms with close government links is increasingly calling into doubt the effectiveness of the EU’s fragmented system of monitoring FDI inflows and their impact across the EU Single Market.

Under the new Regulation, FDI screening and merger control are to be seen as two separate legal frameworks, although there is no requirement for the screening mechanisms in the Member States to be separated from the respective merger control regime. In the UK, which too has amid Brexit negotiations adopted stricter provisions on FDI screening this year, the two mechanisms are integrated.

New control mechanism for foreign mergers & acquisitions

While the objective of the proposal is neither to harmonise the formal FDI screening mechanisms currently used by 12 of the EU Member States nor to replace them with a single EU mechanism, the draft Regulation will introduce a new legal mechanism for the screening of FDI by the EU Member States, aiming to enhance the coordination of FDI screening between the Commission and Member States, in order to increase legal certainty and transparency. Although the European Commission's opinion will be legally non-binding and of advisory nature, Member States will need to take the "utmost account" of the Commission's opinion and provide an explanation if it is not followed. It is therefore expected to significantly influence the decisions to be taken by the Member States in which the
Key elements of the proposed legislation

The proposed Regulation will bring about three key changes:

1. **EU competence to screen FDI of 'Union interest' and issue a non-binding opinion** - The Commission will be authorised to screen investment projects of 'Union interest' and to issue a non-binding opinion if (1) an FDI in a Member State may affect the security or public order of projects 'of Union interest' in the fields of research, space, transport, energy and telecommunications; or if (2) an FDI in a Member State may affect the security or public order of another/other Member State/s.

2. **Minimum requirements** - There is no obligation to introduce a screening mechanism, but if a Member State decides to do so, the competent authorities will need to fulfil minimum requirements (such as the principle of non-discrimination, the protection of confidential information and the right to judicial review), and comply with time limits for national FDI review procedures. The Commission will issue guidance on factors to consider in the screening of FDI.

3. **EU cooperation mechanism** - The new mechanism created between Member States and the Commission will enhance the coordination of screening decisions taken by the Member States concerned, aiming to increase the awareness of Member States and the Commission about planned or completed FDI that may affect security or public order by way of exchanges of information.

Key changes to the initial Commission proposal

The final text is reported to include a tougher screening mechanism than originally proposed by the Commission. The two key changes include:

1. **The obligation on the Commission to screen deals** - Under the initial proposal, the Commission was given the choice to screen FDI, while the new text obliges the Commission to carry out screening where the FDI is likely to affect projects or programmes of Union interest.

2. **An extension of the list of critical sectors** - The list of critical sectors is now broader than in the Commission proposal and now also includes aerospace, health, nano-technology, the media, electric batteries and the supply of food.

Key implications

- **Less centralised than CFIUS** - While the Committee on Foreign Investment in the US (CFIUS) may review, investigate, block or even unwind a transaction, under the new EU Regulation the final decision on a transaction rests with the Member States.

- **Types of FDI** - The new Regulation covers any investments by a foreign investor aiming to establish or maintain lasting and direct links to the target undertaking "to carry on an economic activity in a Member State". FDI screening must therefore be factored into acquisition planning.

- **Sectors of industry** - The draft Regulation comprises a non-exhaustive list of factors to be accounted for during the screening, including critical infrastructure and technologies, access to sensitive information, and whether a foreign investor is controlled or funded by a third country government.

- **Powers to be transferred to the EU level** - The final decision-making power on FDI in the EU will remain with the Member States, as the new framework will primarily seek to enhance cooperation on FDI screening between the Commission and the Member States.

Next steps

Once the text has been technically finalised, the Member States in the Council and the European Parliament are expected to formally adopt the provisional agreement in early December for the Regulation to subsequently enter into force. The Commission is currently conducting a comprehensive analysis of the FDI flows into the EU and has established a coordination group with Member States, which aims to identify joint strategic concerns and possible solutions as regards FDI.
How DLA Piper can assist you

- **Briefings & impact assessments** - In order to raise the awareness of relevant stakeholders throughout the EU and beyond as regards the impact of the new rules on specific stakeholders or sectors of industry, our team stands ready to provide tailored briefings and impact assessments to government as well as corporate actors.

- **Protecting EU interests and company interests** - Our team is well-placed to assist EU companies potentially affected by inward FDI and/or by the new Regulation. This can be done by representing EU-based companies individually or by establishing alliances with other relevant EU government or private stakeholders to effectively represent the client's interest in the process of future EU screenings of FDI.

- **Stakeholder engagement** - In view of the Commission's expected greater influence on future screenings of FDI in the EU that may affect the EU's strategic interest or that of other Member States, the team is experienced in assisting EU companies by engaging with the relevant institutional stakeholders.

- **Advising foreign investors** - The team stands ready to advise and to provide an upfront assessment to foreign investors on the legal and political criteria of the new mechanism, in order to help acquisition planning and to get the deal through.

**AUTHORS**

- **Bertold Bär-Bouyssière**
  Partner
  Brussels | T: +32 (0) 2 500 1500
  [email protected]

- **Joaquín Hervada**
  Partner
  Madrid | T: +34 91 319 12 12
  [email protected]